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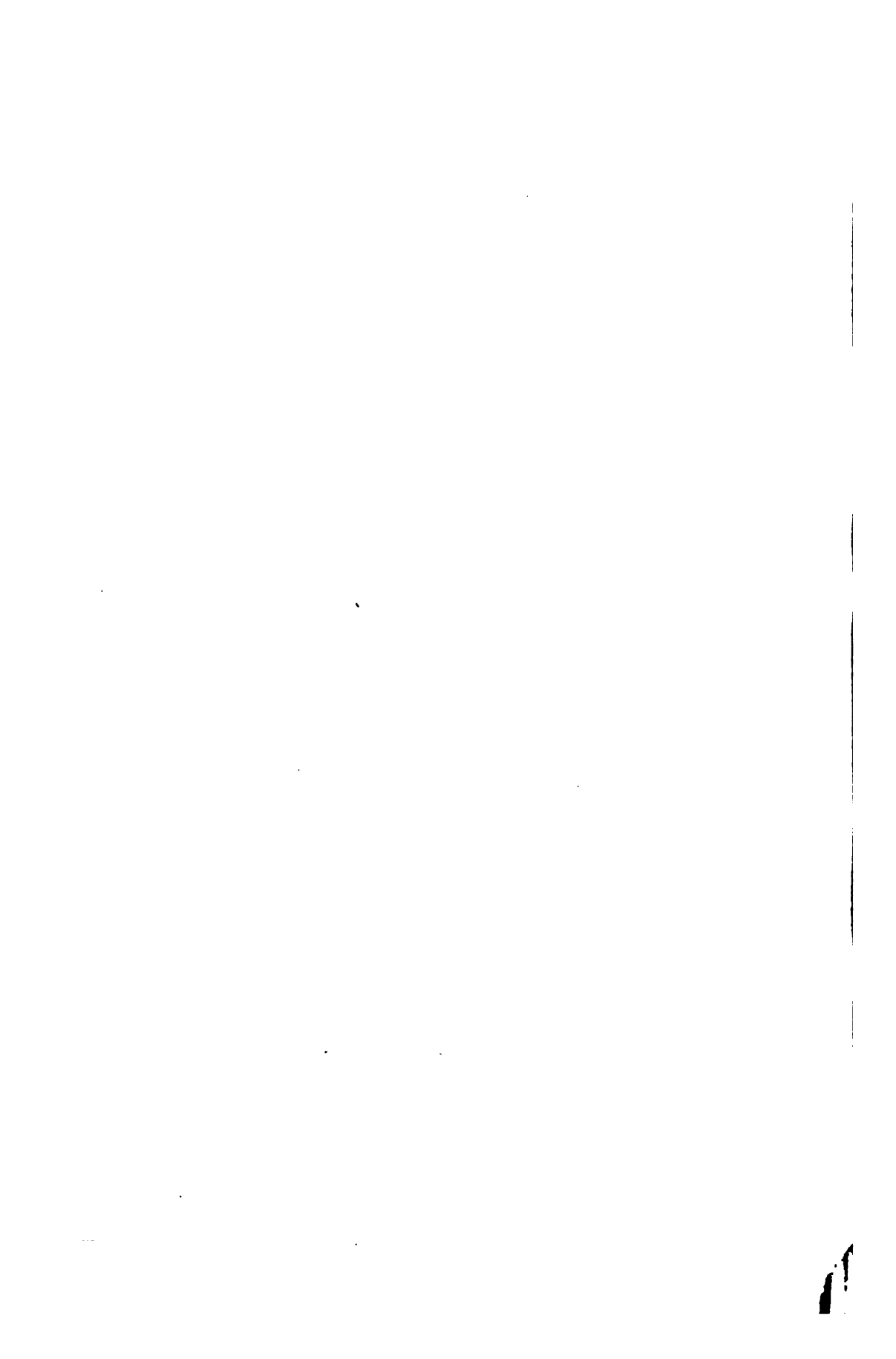
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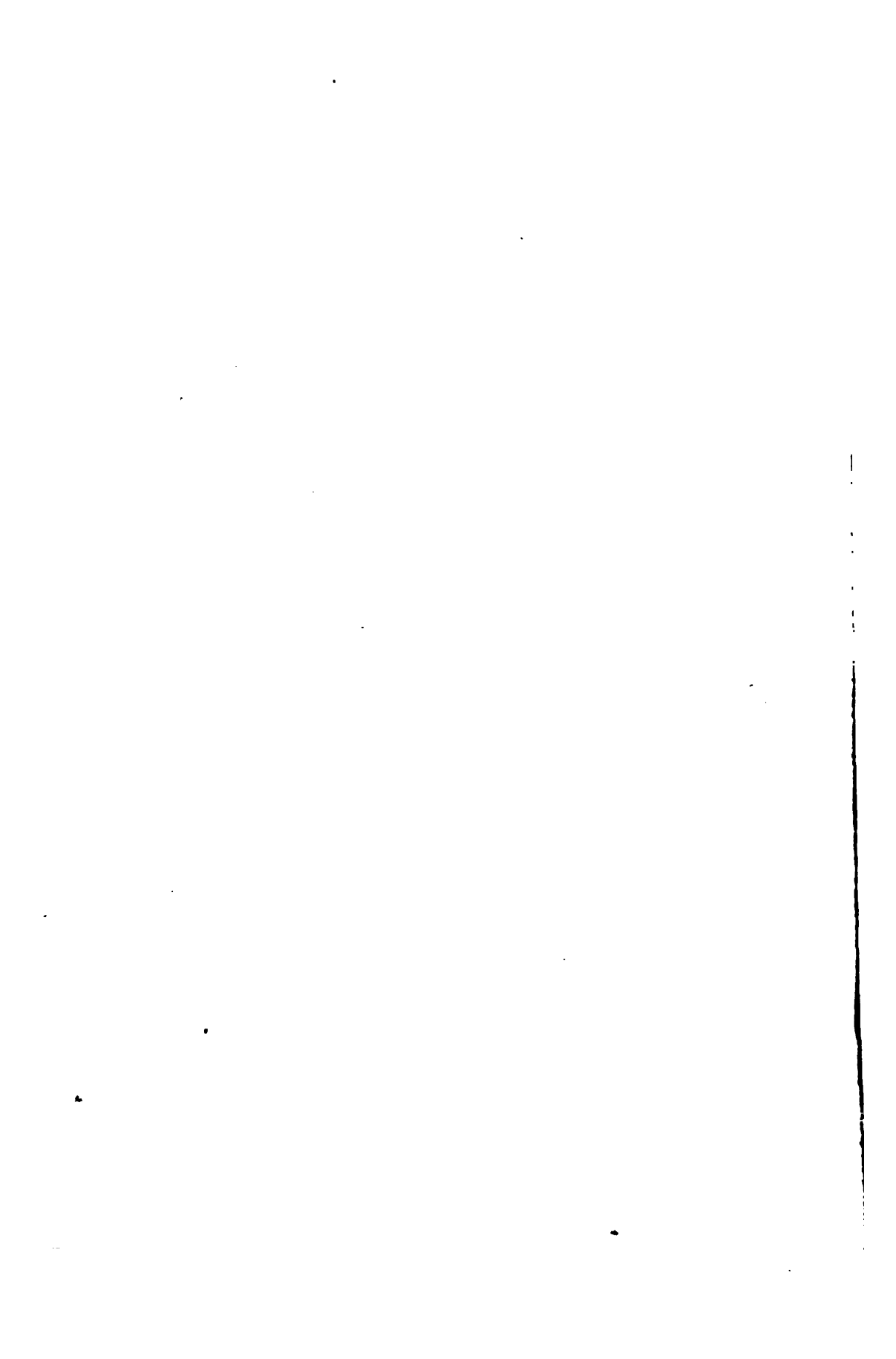
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LEADING CASES  
ON  
PRIVATE CORPORATIONS

TO ACCOMPANY

PRINCIPLES OF PRIVATE CORPORATIONS

BY  
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## PREFATORY NOTE.

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The cases comprising this collection are part second of the author's treatise on the Principles of the Law of Private Corporations. They have been selected to accompany and illustrate the text. Some of the cases are of permanent and historical value, being learned monographs upon certain titles of the law, while others are useful by reason of the application of the law to the facts of the particular case. All will repay careful study. A certain famous lawyer was wont to say that a sudden meeting with *Lickbarrow v. Mason* brought the tears to his eyes—tender memories of early friends. I would have the student form such intimate relations with the cases printed in this volume that they will be something more than mere names. There are few lawyers who would volunteer the information that they had never read the decision of Chief Justice Marshall in the *Dartmouth College Case*, and yet I greatly fear that the testimony of many as to the logical strength of the argument would be subject to the objection that it was hearsay.

Charles Lamb was in the habit of referring to certain standard works as books which no gentleman's library should be without, but which no gentleman was expected to read. Many of the famous decisions of great judges are at present placed in this eminently respectable, but scarcely useful, category.

The book is intended primarily for the use of students of the law, and I hope that it will be of peculiar value to such as have not access to large libraries, with the consequent facilities for the examination of cases.

*Minneapolis, March 1, 1895.*

CUPIDAE LEGUM JUVENTUTI.

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## CHAPTER I.

## DEFINITION AND CLASSIFICATION.

THOMAS V. DAKIN.\*

SUPREME COURT OF NEW YORK, 1839.

(22 Wend. 2.)

*Nature of a Corporation.*

Nelson, C. J.: This is an action brought by the plaintiff, as president of the bank of Central New York, an association formed under what is familiarly known as the General Banking Law, passed April 18, 1838, to recover several demands due the institution.

The defendant has demurred to the declaration, and urges the unconstitutionality of the law, by way of defense; and it is insisted, in his behalf: 1. That the associations formed under this law are corporations; and 2. That a general law authorizing the creation of these bodies is inconsistent with the ninth section of the seventh article of the Constitution. On the part of the plaintiffs, it is urged in reply: 1. That the associations are not corporations: 2. That if they be, the act authorizing them may be passed by a majority bill; and 3. If within the ninth section, still the law may be passed by two-thirds of the members elected.

I. Are these associations corporations? In order to determine this question, we must first ascertain the properties essential to constitute a corporate body, and compare them with those conferred upon the associations; for if they exist in common, or substantially correspond, the answer will be in the affirmative. A corporate body is known to the law by the powers and faculties bestowed upon it, expressly or impliedly, by the charter; the use of the term "corporation" in its creation is of itself unimportant, except as it will imply the possession of these. They may be expressly conferred, and then they denote this legal being

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\*See as to the nature of corporations, *Warner v. Beers*, 23 Wend (N. Y.) 108 (1840); *The Conservators of the river Tone v. Ash*, 10 Barn v. Cress, 349 (1829.)

as unerringly as if created in general terms. It has been well said by learned expounders, that a corporation aggregate is an artificial body of men, composed of divers individuals, the ligaments of which body are the franchises and liberties bestowed upon it, which bind and unite all into one, and in which consists the whole frame and essence of the corporation.

The "franchises and liberties," or, in modern language, and as more strictly applicable to private corporations, the powers and faculties, which are usually specified as creating corporate existence, are: 1. The capacity of perpetual succession; 2. The power to sue and be sued, and to grant and receive, in its corporate name; 3. To purchase and hold real and personal estate; 4. To have a common seal; and 5. To make by-laws. These *indicia* were given by judges and elementary writers at a very early day; since which time the institutions have greatly multiplied, their practical operation and use have been thoroughly tested, and their peculiar and essential properties much better understood. Any one comprehending the scope and purpose of them, at this day, will not fail to perceive that some of the powers above specified are of trifling importance, while others are wholly unessential. For instance, the power to purchase and hold real estate is not otherwise essential than to afford a place of business; and the right to use a common seal, or to make by-laws, may be dispensed with altogether. For as to the one, it is now well settled that corporations may contract by resolution, or through agents, without seal; and as to the other, the power is unnecessary in all cases where the charter sufficiently provides for the government of the body. The distinguishing feature, far above all others, is the capacity conferred, by which a perpetual succession of different persons shall be regarded in the law as one and the same body, and may at all times act, in fulfilment of the objects of the association, as a single individual. In this way, a legal existence, a body corporate, an artificial being, is constituted, the creation of which enables any number of persons to be concerned in accomplishing a particular object, as one man. While the aggregate means and influence of all are wielded in effecting it, the operation is conducted with the simplicity and individuality of a natural person. In this consists the essence and great value of these institutions. Hence it is apparent that the only properties that can be regarded strictly as essential, are those which are indispensable to mould the different persons into this artificial being, and thereby enable it to act in the way above stated. When once constituted, this legal being created, the powers and faculties that may be conferred are various,—limited or enlarged, at the discretion of the legislature, and will depend upon the nature and object of the institu-

tion, which is as competent as a natural person to receive and enjoy them. We may, in short, conclude by saying, with the most approved authorities at this day, that the essence of a corporation consists in a capacity: 1. To have a perpetual succession under a special name and in an artificial form; 2. To take and grant property, contract obligations, sue and be sued by its corporate name as an individual; and 3. To receive and enjoy in common, grants of privileges and immunities.

We will now endeavor to ascertain with exactness, the powers and attributes conferred upon these associations by virtue of the statute. The first fourteen sections (1 to 14) prescribed the duties of the comptroller in furnishing notes for circulation, taking the required securities, etc. The 15th provides, that any number of persons may associate to establish offices of discount, deposit, and circulation. The 16th, that they shall make and file a certificate, specifying: 1. The name to be used in the business; 2. The place where the business shall be carried on; 3. The amount of capital stock, and number of shares into which divided; 4. The names of the shareholders; 5. The duration of the association. The 18th confers upon the persons thus associating, the most ample powers for carrying on banking operations, together with the right "to exercise such incidental powers as shall be necessary to carry on such business;" also to choose a president, vice-president, cashier, and such other officers and agents as may be necessary. By the 21st and 22d sections, contracts, notes, bills, etc., shall be signed by the president and cashier; and all suits, actions, etc., are to be brought in the name of, and also against the president for the time being; and not to abate by his death, resignation, or removal, but to be continued in the name of the successor. 24th section: The association may purchase and hold real estate, etc., the conveyance to be made to the president, or such other officer as shall be designated, who may sell and convey the same free from any claim against shareholders. 19th section: The shares of capital stock to be deemed personal property, transferable on the books of the association; and every person becoming a shareholder by such transfer, shall succeed to all the rights and liabilities of the prior holder. 23d section: No shareholder to be personally liable; and the association is not to be dissolved by the death or insanity of any shareholder.

1. Upon a perusal of these provisions, it will appear that the association acquires the power to raise and hold for common use any given amount of capital stock for banking purposes, which, when subscribed, is made personal property, and the several shares transferable the same and with like effect as in case of corporate stock; to assume a common name under which to

manage all the affairs of the association; to choose all officers and agents that may be necessary for the purpose, and remove and appoint them at pleasure. It will hence be seen, that although the association may be composed of a number of different persons, holding an interest in the capital stock, its operations are so arranged that they do not appear in conducting its affairs; all are so bound together, so moulded into one, as to constitute but a single body, represented by a common name, or names (the knot of the combination), and in which all the business of the institution is conducted by common agents. In this way it purchases and holds real and personal property, contracts obligations, discounts bills, notes, and other evidences of debt, receives deposits, buys gold and silver bullion, bills of exchange, etc., loans money, sues and is sued, etc. It is true, some portion of the business is conducted in the assumed name, and some in the name of the president for the time being; but this in no manner changes the character of the body. A corporation may have more than one name; it may have one in which to contract, grant, etc., and another in which to sue and be sued; so it may be known by two different names, and may sue and be sued in either; and the name of the president, his official name, or any other, will answer every purpose (2 Bacon's Abr. 5; 2 Salk. 451; 2 *id.* 257; Ld. Raym. 153, 680). The only material circumstance is a name, or names, of some kind, in which all the affairs of the company may be conducted. So much, and no more, is essential to give simplicity and effect to the operation. An artificial being is thus plainly created, capable of receiving all the ample powers and privileges conferred upon the associations, and of managing their diversified concerns in an individual capacity. All business is to be conducted in a common or proper name.

2. This artificial being possesses the powers of perpetual succession. Neither sale or shares, nor death of shareholders, affects it; if one should sell his interest or die, the purchaser or representative, by operation of law, immediately takes his place. § 19. Nor can the insanity of a member work a dissolution. Officers and agents for conducting the business of the association are secure. In case of vacancy, by death or otherwise, the place may at once be filled. § 18. For the entire duration, therefore, of the association, and which may be without limit, § 15 sub. 5, the whole body of shareholders, though perpetually changing, constitute the same uniform, artificial being which is to be engaged through the instrumentality of officers and agents in conducting the business of the concern, and no member is personally liable. § 23. Then, as to the powers conferred, without again specially recurring to them, it will be seen at once that the associations possess all that are deemed essential according to

the most approved authorities, to constitute a corporate body. They have a capacity: 1. To have perpetual succession under a common name and in an artificial form; 2. To take and grant property, contract obligations, to sue and be sued by its corporate name, in the same manner as an individual; 3. To receive grants of privileges and immunities, and to enjoy them in common. All these are expressly granted, and many more, besides the general sweeping clause, "to exercise such incidental powers as shall be necessary to carry on such business" (meaning the business of banking), under which even the seal and right to make by-laws are clearly embraced, if essential in conducting the affairs of the institution. \* \* \* \*

Upon the whole, I am of the opinion, 1. That these associations are corporations; 2. That the legislature possesses no power to pass a general law like the one under consideration, by a majority bill; and 3. That they may pass it by two-thirds of the members elected.

The plaintiff is, therefore, entitled to judgment on the demurrer, with leave to amend on the usual terms.

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## STATE V. STANDARD OIL CO.

SUPREME COURT OF OHIO, 1892.

(49 Ohio St, 137.)

### *Nature of a Corporation.*

This is an application by the state for a writ of *quo warranto* against the Standard Oil Company, a corporation organized under the laws of the State of Ohio to oust it of the right to be a corporation on the ground that it has abused its corporate franchises by becoming a party to an agreement that is against public policy. Demurrer to the answer.

Minshall, J.: \* \* \* It will be observed on reading the answer that while the defendant denies that it "entered into or become a party to either or both of the agreements in said petition set forth" and also "denies that it has at any time or in any manner acquiesced therein or observed, performed, or carried out either or both of said agreements," it does not deny the averment of the petition that "all of the owners and holders of its capital stock, including all the officers and directors of said company, signed said agreements." Nor could it have been the intention to do so,

as the answer proceeds to admit "that it [the corporation] is informed and believes that the individuals named in the agreement, being the same individuals who executed" it, "did enter into the agreements set forth" in the petition; claiming "that said agreements were agreements of individuals in their individual capacity and with reference to their individual property, and were not, nor were they designed to be, corporate agreements." The claim is based upon the argument that the corporation is a legal entity, separate from its stockholders; that in it are vested all the property and powers of the company, and can only be affected by such acts and agreements as are done or executed on its behalf by its corporate agencies, acting within the legitimate scope of their powers; that its stockholders are not the corporation; that their shares are their individual property, and that they may each and all dispose of and make such agreements affecting their shares as best suits their private interests; and that no such acts and agreements of stockholders, subservient of their private interests, can be ascribed to the company as a separate entity, though done and concurred in by each and all of its stockholders. The general proposition that a corporation is to be regarded as a legal entity, existing separate and apart from the natural persons composing it, is not disputed; but that the statement is a mere fiction, existing only in idea, is well understood, and not controverted by any one who pretends to accurate knowledge on the subject. It has been introduced for the convenience of the company in making contracts, in acquiring property for corporate purposes, in suing and being sued, and to preserve the limited liability of the stockholders by distinguishing between the corporate debts and property of the company and of the stockholders in their capacity as individuals. All fictions of law have been introduced for the purpose of convenience, and to subserve the ends of justice. It is in this sense that the maxim *in fictione juris subsistit æquitas* is used, and the doctrine of fictions applied. But when they are urged to an intent and purpose not within the reason and policy of the fiction, they have always been disregarded by the courts. Broom, Leg. Max. 130. "It is a certain rule," says Lord Mansfield, C. J., "that a fiction of law shall never be contradicted so as to defeat the end for which it was invented, but for every other purpose it may be contradicted." Johnson v. Smith, 2 Burrows, 962. "They were invented," says Brinkerhoff, J., in Wood v. Ferguson, 7 Ohio St. 291, "for the advancement of justice, and will be applied for no other purpose." And it is in this sense that they have been constantly understood and applied in this state. Hood v. Brown, 2 Ohio, R. 269; Roseman v. McFarland, 9 Ohio St. 381; Collards' Admr. v. Donaldson, 17 Ohio, R. 266.

No reason is perceived why the principles applicable to fictions in general should not apply to the fiction "that a corporation is a personal entity, separate from the natural persons who compose it, and for whose benefit it has been invented." One author seems to think that it has outlived its usefulness; that it is "a stumbling block in the advance of corporation law towards the discrimination of the real rights of actual men and women," and should be abandoned. Taylor Corp. § 51. Among the many attempts that have been made to define the nature of a corporation, that given by Mr. Kyd, discarding, or at least not adopting, the metaphysical distinction of a legal entity separate from the persons comprising it, is certainly the most practical, presenting, as it does, the real nature of a corporation as seen in its constituents, and in the manner that it is formed and transacts its business. His definition is: "A collection of many individuals united into one body, under a special denomination, having perpetual succession under an artificial form, and vested by the policy of the law with the capacity of acting in several respects as an individual, particularly of taking and granting property, of contracting obligations, and of suing and being sued, of enjoying privileges and immunities in common, and of exercising a variety of political rights more or less extensive according to the design of its institution or the powers conferred upon it, either at the time of its creation or any subsequent period of its existence." 1 Kyd, Corp. 13. In brief, then, a corporation is a collection of many individuals, united in one body under a special denomination, and vested by the policy of the law with the capacity of acting in several respects as an individual. "The statement," says Mr. Morawetz, "that a corporation is an artificial person or entity apart from its members, is merely a description, in figurative language, of a corporation viewed as a collective body. A corporation is really an association of persons, and no judicial *dictum* or legislative enactment can alter this fact." See his work on Corporations, § 227. So that the idea that a corporation may be a separate entity, in the sense that it can act independently of the natural persons composing it, or abstain from acting, where it is their will that it shall, has no foundation in reason or authority, is contrary to the fact, and to base an argument upon it, when the question is as to whether a certain act was the act of the corporation or of its stockholders, cannot be decisive of the question, and is therefore illogical; for it may as likely lead to a false as to a true result.

Now, so long as a proper use is made of the fiction that a corporation is an entity apart from its shareholders, it is harmless, and, because convenient, should not be called in question; but where it is urged to an end subversive of its policy, or such is the



issue, the fiction must be ignored, and the question determined whether the act in question, though done by shareholders,—that is to say, by the persons uniting in one body,—was done simply as individuals, and with respect to their individual interests as shareholders, or was done ostensibly as such, but, as a matter of fact, to control the corporation, and affect the transaction of its business, in the same manner as if the act had been clothed with all the formalities of a corporate act. This must be so, because, the stockholders having a dual capacity, and capable of acting in either, and a possible interest to conceal their character when acting in their corporate capacity, the absence of the formal evidence of the character of the act cannot preclude judicial inquiry on the subject. If it were otherwise, then in one department of the law fraud would enjoy an immunity awarded to it in no other.

Therefore the real question we are now to determine is whether it appears from the face of the pleadings, giving effect to all the denials of fact contained in the answer, that the execution of the agreement set forth in the petition should be imputed to the association of persons constituting the Standard Oil Company of Ohio, acting in their corporate capacity. The agreement provides, in the first place, that the parties to it shall be divided into three classes, the first class to embrace all the stockholders and members of certain corporations and limited partnerships, the defendant, the Standard Oil Company of Ohio, being one. It is then covenanted by the parties that as soon as practicable a corporation shall be formed in each of certain states, under the laws thereof, (Ohio being one,) to mine for, produce, manufacture, refine, and deal in petroleum and all its products, with the proviso, however, that, instead of organizing a new corporation, any existing one "may be used for the purpose when it can advantageously be done," and in Ohio the defendant has been so used. In a subsequent part of the agreement nine trustees are selected, their powers and duties are defined, and provision made for the selection of their successors. As will hereafter appear, it is made the duty of the parties to the agreement to transfer their stocks or interests in their respective companies or firms to these trustees who hold the same in trust, but with the power to vote on the same as though the real owners; in consideration of which trust certificates are issued to the owners, who, as the owners of such certificates, elect the successors of the trustees. It is then provided that all the property, assets, and business of the corporations and limited partnerships embraced in the first class "shall be transferred to and vested in the said several Standard Oil Companies." And in order to accomplish this purpose it is provided that "the directors and managers of each and all of the several corporations and limited partnership mentioned in class first are

hereby authorized and directed by the stockholders and members thereof (all of them being parties to this agreement) to sell, assign, transfer, convey and make over, for the consideration hereinafter mentioned, to the Standard Oil Company or companies of the proper state or states, as soon as said corporations are organized and ready to receive the same, all the property real and personal, assets, and business of said corporations and limited partnerships."

Now, in the case of the defendant it will be observed, that this contemplated, and could not have been accomplished, without corporate action. The Standard Oil Company of Ohio, was required to transfer all its property, assets, and business to a new company, to be organized in the state; and this was to be accomplished by the obligation imposed on its members and stockholders, all of whom are parties to the agreement, to authorize and require the directors and managers to make the transfer. The property and assets of the corporation could only be transferred by a corporate act, and the agreement could not, in this respect, be carried into effect, other than by such corporate act, and clearly indicates that the purpose of the stockholders of the defendant in becoming a party to it was to affect their property and business as a corporation; in other words, was to act in their corporate, and not in their individual capacity. The subsequent agreement of January 4, 1882, does not materially change the original agreement in this regard. Reciting that "it is not deemed expedient that all of the companies and associations should transfer their property to the said Standard Oil Companies at the present time," and "that it is deemed advisable that a discretionary power should be vested in the trustees as to when such transfer" should be made, it provides that, "until said trustees should so decide, each of said companies shall remain in existence and retain its property and business; and the trustees shall hold the stock thereof in trust as in said agreement provided." So that, under the agreement as modified, the directors and managers of the defendant may be required by its stockholders and members, all of whom are parties to the agreement, to make the transfer of the property and business of the defendant whenever the trustees may, in their discretion, direct. The effectiveness of this provision to secure all intended by it may be better understood by observing that "the directors and managers," "the stockholders and members," and "the trustees" here mentioned are substantially the same persons, occupying these different relations at one and the same time. It signifies nothing that the transfer here provided for has not, as respects the defendant, been made. It does not change the evidence it affords of the purpose

and object of the members of the corporation in becoming parties to the agreement.

Again, the agreement, as performed by the members of the defendant, as effectually places the property and business of the defendant under the control and management of the Standard Oil Trust as if the same had been transferred as provided in the original agreement. It is averred in the petition, and not denied in the answer, "that prior to the dates of the trust agreements aforesaid defendant's capital stock consisted of 35,000 shares of \$100 each, and upon the signing of said agreements in the manner aforesaid 34,993 shares of said stock, belonging to the persons who signed the agreements in manner above set forth, (in what proportions, however, plaintiff is unable to state,) were transferred, by defendants transferring officers upon defendant's stock-books, to the certain nine trustees who were appointed and named in the first one of said trust agreements, upon the request of the respective owners of said shares, and in pursuance of the provisions of said trust agreements; the remaining seven of said shares of stock being retained by or transferred to the directors of defendant company. That at the time said transfer of stock was made there were seven directors of defendant, and each one of the seven held one share of the stock aforesaid, but the number of said directors was thereafter reduced to five, who still hold and vote said seven shares of stock, and no more. That in lieu of the transfer of said 34,993 shares, as aforesaid, to the nine trustees above mentioned, an equal amount, in par value, of certificates of the Standard Oil Trust, which were provided for and described in said trust agreements, was issued and delivered by said nine trustees to the persons aforesaid, from whom said nine trustees had received said 34,993 shares of stock in defendant company. That the capital stock of said defendant company is still \$3,500,000, and the nine trustees before mentioned still hold and control the 34,993 shares thereof which were transferred to them as above stated." So that all but seven of the 35,000 shares of the defendant's capital stock has been transferred by the owners, who are parties to the agreement, to the trustees of the Standard Oil Trust, and continue to be held in trust, as appears by the supplemental agreement the transferrers receiving in lieu thereof trust certificates equal at par value to the par value of the stock received. The control which this gives and was intended to give over the business of the defendant appears from the following provision contained in the trust agreement: "It shall be the duty of said trustees to exercise general supervision over the affairs of said several Standard Oil Companies, and as far as practicable over the other companies or partnerships any portion of whose stock is held in said trust. It shall be their duty, as

stockholders of said companies, to elect as directors and officers thereof faithful and competent men. They may elect themselves to such positions when they see fit so to do, and shall endeavor to have the affairs of said companies managed and directed in the manner they may deem most conducive to the best interests of the holders of said trust certificates." Thus the trustees, as the legal owners of the stock, may not only elect who they please, but may elect themselves, as directors of the defendant; and not only may manage, but it is their duty to have "the affairs" of the defendant managed and directed in the manner they may deem most conducive to the best interests of the holders of the trust certificates. In other words, it is to be managed in the interests of the Standard Oil Trust, whose principal place of business is in New York City, irrespective of what might be its duties to the people of this state, from which it derives its corporate life; and its real stockholders receive their dividends from the profits of that trust, and not from the earnings of their company; for the holders of the trust certificates received in exchange for their stock transferred to the trustees remain, in law and in equity, the real owners of the stock so transferred. And the averment in the answer that the dividends of the company are paid to the holders of its stock, "appearing as such on its stock-books," is immaterial, since these persons are not the owners, but the trustees, of the stock. In fact, the averment is simply a part of the evidence that the company, through its directors, recognizes and performs the agreement on its part. The payment of its dividends to the persons appearing as stockholders on its stock-books is what enables the parties to the agreement to realize the primary object of the trust agreement,—the accumulation of the earnings of the various companies, partnerships, and individuals named in the agreement, as a common fund, from which the holders of the trust certificates are to be paid dividends when declared by the trustees, and whereby many separate interests, being united under one management, form a virtual monopoly, through the power acquired, of so controlling the production and price of petroleum and its products as to destroy competition.

Applying, then, the principle that a corporation is simply an association of natural persons, united in one body under a special denomination, and vested by the policy of the law with the capacity of acting in several respects as an individual, and disregarding the mere fiction of a separate legal entity, since to regard it in an inquiry like the one before us would be subversive of the purpose for which it was invented, is there, upon an analysis of the agreement, room for doubt that the act of all the stockholders, officers, and directors of the company in signing it should be imputed to them as an act done in their capacity as a corpora-

£2,000,000, which was divided into one hundred thousand shares of £20 each, and declared its purpose to be, making insurance on life and against fire. These shares could be sold and transferred, and executors and administrators represented them in the company on the death of the owner. If, by the laws of the association, a share became forfeited, the owner was released from all further liability to the company. The business of the company was to be conducted by a board of directors, exclusively, and they could make by-laws and change and modify them. There was a covenant that suits might be brought by or against the company in the names of one or more directors, which should bind the stockholders, and that no stockholder would plead in abatement the nonjoinder of the others; and it was further covenanted that a judgment so obtained against a director might be made out of the property of any of the stockholders. Numerous other provisions are found in the original articles, which consisted of over a hundred sections, but only those are referred to here which bear on the question we are considering. There were also three subsequent deeds of settlement, and three Acts of Parliament were passed to give efficiency to the purposes of the association.

The first of these Acts provided that the association might sue and be sued in the name of the chairman or deputy-chairman of the board of directors; that the stockholders might sue the company as plaintiffs, or be sued by it as defendants. It regulated the manner in which the shareholders might be made individually liable for the debts of the association; and it declared that the Act should not be construed to incorporate the company or relieve its members from their individual liability, except as provided in the Act.

The second Act of Parliament changed the name of the company to that which it now bears, and authorized it to make contracts by the new name; and it also contained a provision that the Act should not make the company a corporation; and there was a third Act which authorized amalgamation with another company, and which again provides against its being construed into an Act of incorporation or a limited liability partnership.

Mr. Justice Miller: The case of *Paul v. Virginia*, 8 Wall. 168, decided that the business of insurance, as ordinarily conducted, was not commerce, and that a corporation of one State, having an agency by which it conducted the business in another State, was not engaged in commerce between the States.

It was also held in that case that a corporation was not a citizen within the meaning of that clause of the Constitution which declares that the citizens of each State shall be entitled

to all the privileges and immunities of citizens in the several States, and that a corporation created by a State could exercise none of the functions or privileges conferred by its charter in any other State of the Union, except by the comity and consent of the latter.

These propositions dispose of the case before us, if plaintiff is a foreign corporation, and was, as such, conducting business in the State of Massachusetts, and we proceed to inquire into its character in this regard.

The institution now known as the Liverpool and London Life and Fire Insurance Company, doing an immense business in England and in this country, was first organized at Liverpool by what is there called a deed of settlement, and would here be called articles of association.

It will be seen by reference to the powers of the association, as organized under the deed of settlement, legalized and enlarged by the Acts of Parliament, that it possesses many, if not all, the attributes generally found in corporations for pecuniary profit which are deemed essential to their corporate character.

1. It has a distinctive and artificial name by which it can make contracts.

2. It has a statutory provision by which it can sue and be sued in the name of one of its officers as the representative of the whole body, which is bound by the judgment rendered in such suit.

3. It has provision for perpetual succession by the transfer and transmission of the shares of its capital stock, whereby new members are introduced in place of those who die or sell out.

4. Its existence as an entity apart from the shareholders is recognized by the Act of Parliament which enables it to sue its shareholders and be sued by them.

The subject of the powers, duties, rights and liabilities of corporations, their essential nature and character, and their relation to the business transactions of the community, have undergone a change in this country within the last half century, the importance of which can hardly be overestimated.

They have entered so extensively into the business of the country, the most important part of which is carried on by them, as banking companies, railroad companies, express companies, telegraph companies, insurance companies, etc., and the demand for the use of corporate powers in combining the capital and the energy required to conduct these large operations is so imperative, that both by statute, and by the tendency of the courts to meet the requirements of these public necessities, the law of corporations has been so modified, liberalized and enlarged,

as to constitute a branch of jurisprudence with a code of its own, due mainly to very recent times. To attempt, therefore, to define a corporation, or limit its powers by the rules which prevailed when they were rarely created for any other than municipal purposes, and generally by royal charter, is impossible in this country and at this time.

Most of the States of the Union have general laws by which persons associating themselves together, as the shareholders in this company have done, become a corporation.

The banking business of the States of the Union is now conducted chiefly by corporations organized under a general law of Congress, and it is believed that in all the States the articles of association of this company would, if adopted with the usual formalities, constitute it a corporation under their general laws, or it would become so by such legislative ratification as is given by the Acts of Parliament we have mentioned.

To this view it is objected that the association is nothing but a partnership, because its members are liable individually for the debts of the company. But however the law on this subject may be held in England, it is quite certain that the principle of personal liability of the shareholders attaches to a very large proportion of the corporations of this country, and it is a principle which has warm advocates for its universal application when the organization is for pecuniary gain.

So, also, it is said that the fact that there is no provision either in the deed of settlement or the Act of Parliament for the company suing or being sued in its artificial name forbids the corporate idea. But we see no real distinction in this respect between an Act of Parliament, which authorized suits in the name of the Liverpool and London Fire and Life Insurance Company, and that which authorized suit against that company in the name of its principal officer. If it can contract in the artificial name and sue and be sued in the name of its officers on those contracts, it is in effect the same, for process would have to be served on some such officer even if the suit were in the artificial name.

It is also urged that the several Acts of Parliament we have mentioned expressly declare that they shall not be held to constitute the body a corporation.

But whatever may be the effect of such declaration in the courts of that country, it cannot alter the essential nature of a corporation or prevent the courts of another jurisdiction from inquiring into its true character, whenever that may come in issue. It appears to have been the policy of the English law to attach certain consequences to incorporated bodies, which rendered it desirable that such associations as these should not become technically corporations. Among these, it would seem

from the provisions of these Acts, is the exemption from individual liability of the shareholder for the contracts of the corporation. Such local policy can have no place here in determining whether an association, whose powers are ascertained and its privileges conferred by law, is an incorporated body.

The question before us is, whether an association, such as the one we are considering, in attempting to carry on its business in a manner which requires corporate powers under legislative sanction, can claim, in a jurisdiction foreign to the one which gave those powers, that it is only a partnership of individuals.

We have no hesitation in holding that, as the law of corporations is understood in this country, the association is a corporation, and that the law of Massachusetts, which only permits it to exercise its corporate function in that State on the condition of payment of a specific tax, is no violation of the Federal Constitution or of any treaty protected by said Constitution.

Judgment affirmed.

Mr. Justice Bradley, dissenting: Whilst I agree in the result which the court has reached, I differ from it on the question whether the company is a corporation. I think it is one of those special partnerships which are called joint stock companies, well known in England for nearly a century, and cannot maintain an action or be sued as a corporation in this country without legislative aid. But as it is a company associated under the laws of a foreign country, it comes within the scope of the Massachusetts Statute, and cannot claim exemption from its operation for the causes alleged in that behalf. It could not have been the intent of the Treaty of 1815 to prevent the States from imposing taxes or license laws upon either British corporations or joint stock companies desiring to establish banking or insurance business therein. And certainly these companies cannot be exempted from such laws on the ground that citizens of other States have chosen to take some of their shares.



## BUTTON v. HOFFMAN.\*

SUPREME COURT OF WISCONSIN, 1884.

(61 Wis. 20.)

*Nature of a Corporation—Title of Property in Corporation—Corporation Sole.*

Orton, J.: This is an action of replevin in which the title of the plaintiff to the property was put in issue by the answer. In his instructions to the jury the learned judge of the circuit court said: "I think the testimony is that the plaintiff had the title to the property." The evidence of the plaintiff's title was that the property belonged to a corporation known as "The Hayden & Smith Manufacturing Company," and that he purchased and became the sole owner of all of the capital stock of said corporation. As the plaintiff in his testimony expressed it, "I bought all the stock. I own all the stock now. I became the absolute owner of the mill. It belonged at that time to the company, and I am the company." There was no other evidence of the condition of the corporation at the time. Is this sufficient evidence of the plaintiff's title? We think not. The learned counsel of the respondent in his brief says: "The property had formerly belonged to the Hayden & Smith Manufacturing Company, but the respondent had purchased and become the owner of all the stock of the company, and thus became its sole owner."

From the very nature of a private business corporation, or, indeed, of any corporation, the stockholders are not the private and joint owners of its property. The corporation is the real, though artificial, person substituted for the natural persons who procured its creation, and have pecuniary interests in it, in which all its property is vested, and by which it is controlled, managed and disposed of. It must purchase, hold, grant, sell, and convey the corporate property, and do business, sue and be sued, plead and be impleaded, for corporate purposes, by its corporate name. The corporation must do its business in a certain way, and by its regularly appointed officers and agents, whose acts are those of the corporation only as they are within the powers and purposes of

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\*See *Wheelock v. Moulton*, 15 Vt. 519 (1843); *Swift v. Smith*, 65 Md. 428; *Newton Manufacturing Co. v. White*, 42 Ga. 148; *Belona Co. v. Case*, 3 Bland. 446; *Winona, etc., R. Co. v. St. Paul, etc., R. Co.*, 23 Minn. 359; *King v. Barnes*, 109 N. Y. 267; *Louisville Banking Co. v. Bisenman*, Ky. Court of App., 1893.

the corporation. In an ordinary copartnership the members of it act as natural persons and as agents for each other, and with unlimited liability. But not so with a corporation; its members, as natural persons, are merged in the corporate identity. Ang. & A. Corp. §§ 40, 46, 100, 591, 595. A share of the capital stock of a corporation is defined to be a right to partake, according to the amount subscribed, of the surplus profits obtained from the use and disposal of the capital stock of the company to those purposes for which the company is constituted. Id. § 557. The corporation is the trustee for the management of the property, and the stockholders are the mere *cestui que trust*. *Gray v. Portland Bank*, 3 Mass. 365; *Eidman v. Bowman*, 4 Amer. Corp. Cas. 350.

The right of alienation or assignment of the property is in the corporation alone, and this right is not affected by making the stockholders individually liable for the corporate debts. Ang. & A. Corp. § 191; *Pope v. Brandon*, 2 Stew. (Ala.) 401; *Whitwell v. Warner*, 20 Vt. 444. The property of the corporation is the mere instrument whereby the stock is made to produce the profits, which are the dividends to be declared from time to time by corporate authority for the benefit of the stockholders, while the property itself, which produces them, continues to belong to the corporation. *Bradley v. Holdsworth*, 3 Mees. & W. 422; *Waltham Bank v. Waltham*, 10 Metc. 334; *Tippets v. Walker*, 4 Mass. 595. The corporation holds its property only for the purposes for which it was permitted to acquire it, and even the corporation cannot divert it from such use, and a shareholder has no right to it, or the profits arising therefrom, until a lawful division is made by the directors or other proper officers of the corporation, or by judicial determination. Ang. & A. Corp. §§ 160, 190, 557; *Hyatt v. Allen*, 4 Amer. Corp. Cas. 624. A conveyance of all the capital stock to a purchaser gives to such purchaser only an equitable interest in the property to carry on business under the act of incorporation and in the corporate name, and the corporation is still the legal owner of the same. *Wilde v. Jenkins*, 4 Paige, 481. A legal distribution of the property after a dissolution of the corporation and settlement of its affairs, is the inception of any title of a stockholder to it, although he be the sole stockholder. Ang. & A. Corp. § 779a.

These general principles sufficiently establish the doctrine that the owner of all the capital stock of a corporation does not, therefore, own its property, or any of it, and does not himself become the corporation, as a natural person, to own its property, and do its business in his own name. While the corporation exists he is a mere stockholder of it, and nothing else. The consequences of a violation of these principles would be that the stockholders would

be the private and joint owners of the corporate property, and they could assume the powers of the corporation, and supersede its functions in its use and disposition for their own benefit without personal liability, and thus destroy the corporation, terminate its business, and defraud its creditors. The stockholders would be the owners of the property, and, at the same time, it would belong to the corporation. One stockholder owning the whole capital stock could, of course, do what several stockholders could lawfully do. It is said in *City of Utica v. Churchill*, 33 N. Y. 161, "the interest of a stockholder is of a collateral nature, and is not the interest of an owner;" and in *Hyatt v. Allen, supra*, that "a shareholder in a corporation has no legal title to its property or profits until a division is made." In *Winona & St. P. Railroad Co. v. St. Paul S. C. Railroad Co.*, 23 Minn. 359, it is held that the corporation is still the absolute owner, and vested with the legal title of the property, and the real party in interest, although another party has become the owner of the sole beneficial interest in its rights, property, and immunities. In *Baldwin v. Canfield*, 26 Minn. 43, S. C. 1 N. W. REP. 261, it was held that the sole owner of the stock did not own the land of the corporation so as to convey the same. In *Bartlett v. Brickett*, 14 Allen (Mass.), 62, an action of replevin was brought by A., B., and C., as the "trustees of the Ministerial Fund in the North Parish in Haverhill," which was the corporate name. In portions of the writ the plaintiffs were referred to as "the said trustees" and "the said plaintiffs." In the bond, "A., B., and C., trustees as aforesaid," became bound, and the officer, in his return, certified that he had taken a bond "from the within named A., B., and C.," and the property was receipted by "A., B., and C., plaintiffs." It was held that the action was not by the corporation, as it should have been, and judgment was rendered for the defendant. It is said in *Van Allen v. Assessors*, 3 Wall. 584, "the corporation is the legal owner of all the property of the bank, both real and personal." In *Wilde v. Jenkins, supra*, where a copartnership bought all the property and effects, together with the franchises, of a corporation, and elected themselves trustees of the corporation, it was held that the corporation was not dissolved, and that the legal title to the real and personal property was still in the corporation for their benefit. In *Mickles v. Bank*, 11 Paige, 118, it was held that, although a corporation was deemed to have surrendered its charter for non-user, it was not dissolved, and would not until its dissolution was judicially declared, and that until then its property could be taken and sold by its judgment creditors. In *Bennett v. American Art Union*, 5 Sandf. Super. Ct. 614, it was held that, "as a general rule, the whole title, legal and equitable (to its property), is

vested in the corporation itself," and that the individual members have no other or greater interest in it than is expressly given to them by the charter, and the prayer of the complainant, as a shareholder in the art union, for an injunction against a certain disposition of its property, was denied, because it had no interest in it. See, also, *Goodwin v. Hardy*, 57 Me. 143.

It is true that none of the above cases are precisely parallel with the present case in facts, but they are sufficiently analogous to be authority upon the principle that the plaintiff, as the sole stockholder of the corporation, is not the legal owner of its property. He may have an equitable interest in it, but in this action he must show a legal title to the property in himself in order to recover, and he has shown that such title is in another person. *Timp v. Dockham*, 32 Wis. 146; *Sensenbrenner v. Mathews*, 48 Wis. 250; S. C. 3 N. W. REP. 599. In analogy to the above principle it was held in *Murphy v. Hanrahan*, 50 Wis. 485, S. C. 7 N. W. REP. 436, that the sole heirs of an estate did not have such a legal title to a promissory note given to their father as would entitle them to sue the maker upon it, because the title to it was in the administrator, and they could obtain the title only by administration and distribution according to law. The heirs in that case certainly had as much equitable interest in that note as this plaintiff has in the property in controversy. The want of title to the property being fatal to the plaintiff's recovery in the action between the present parties, other alleged errors will not be considered.

The judgment of the circuit court is reversed, and the cause remanded for a new trial.

## CHAPTER II.

## THE CREATION OF CORPORATIONS.

## FRANKLIN BRIDGE CO. V. WOOD.

SUPREME COURT OF GEORGIA, 1853.

(14 Ga. 80.)

This was an action on a subscription to stock. The defendant claimed that the plaintiff was not legally incorporated, and that the act of the legislature prescribing the mode of incorporating certain corporations was unconstitutional.

Lumpkin, J.: Is the act of 1843 and that of 1845, amendatory thereof, pointing out the manner of creating certain corporations and defining their rights, privileges, and liabilities, unconstitutional?

By the first section of the Act of 1843, it is provided "That when the persons interested shall desire to have any church, campground, manufacturing company, trading company, ice company, fire company, theatre company, or hotel company, bridge company, and ferry company, incorporated, they shall petition in writing the superior or inferior court of the county where such association may have been formed, or may desire to transact business for that purpose, setting forth the object of their association, and the privilege they desire to exercise, together with the name and style by which they desire to be incorporated; and said court shall pass a rule or order directing said petition to be entered of record on the minutes of said court."

Section 2 enacts "That when such rule or order is passed, and said petition is entered of record, the said companies or associations shall have power respectively, under and by the name designated in their petition, to have and use a common seal; to contract and be contracted with; to sue and be sued; to answer and be answered unto in any court of law or equity; to appoint such officers as they may deem necessary; and to make such rules and regulations as they may think proper for their own government; not contrary to the laws of this state; but shall make no contracts or purchase or hold any property of any kind, except such as may be absolutely necessary to carry into effect the object of their incorporation. Nothing herein contained

shall be so construed as to confer banking or insurance privileges on any company or association herein enumerated; and the individual members of such manufacturing, trading, theatre, ice, and hotel companies, shall be bound for the punctual payment of all the contracts of said companies, as in case of partnership."

The third section declares that "No company or association shall be incorporated under this act, for a longer period than fourteen years; but the same may be renewed whenever necessary, according to the provisions of the first section of this act."

The fourth section confers upon the superior and inferior courts respectively, the power to change the names of individuals.

Section fifth. "For entering any of said petitions and orders, and furnishing a certified copy thereof, the clerk shall be entitled to a fee of five dollars; except in cases of applications by individuals for the change of names,—in which case, the clerk of said court shall be entitled to the fee of one dollar. And that such certified copy shall be evidence of the matters therein stated in any court of law and equity in this state." Cobb's Digest, 542, 543.

By the act of 1845 the provisions of the act of 1843 are extended to all associations and companies whatever, except banks and insurance companies; and the individual members of all such incorporations are made personally liable for all the contracts of said associations or companies. Ibid.

The argument against the validity of the charter of the Franklin Bridge Company, created under these statutes, is this:—

1. That in England corporations are created and exist by prescription, by Royal Charter, and by act of Parliament. With us they are created by authority of the Legislature, and not otherwise. That to establish a corporation is to enact a law; and that no power but the legislative body can do this.

2. That legislative power is vested under our Constitution, in the General Assembly, to consist of a Senate and House of Representatives, to be elected at stated periods by the citizens of the respective counties.

3. And that the General Assembly is bound to exercise the power of making laws thus conferred upon them by the people in the primordial compact, in the mode therein prescribed, and in none other; and that a law made in any other mode is unconstitutional and void. That the legislature is but the agent of their constituents; and that they cannot transfer authority delegated to them to any other body, corporate or otherwise,—not even to the Judiciary, a co-ordinate department of the government, unless expressly empowered by the Constitution to do so. That to do this would be to violate one of the fundamental maxims of jurisprudence as well as of political science, namely, *delegata potestas non potest*

*delegari*. That to do this would not only be to disregard the constitutional inhibition which is binding upon the representative, but by shifting responsibility introduce innovations upon our system, which would result in the overthrow and ultimate destruction of our political fabric.

The constitutional inquiry thus presented is an exceedingly grave one. It reaches far beyond the case made in the bill of exceptions, and extends to the whole range of topics which fall under legislative cognizance. In the view we take however of the statutes before us, no such proposition as that which has been discussed is presented for our adjudication. And we rejoice that it is so, not only on account of the delicacy of the task, in pronouncing an act of legislature unconstitutional and void,—one which is never justifiable unless the case is clear and free from doubt; and even then one might almost be forgiven for shrinking from the performance of a duty which would be productive of such incalculable mischief and confusion. Bridges have been built at a heavy expense; manufacturing and innumerable other associations have been formed in Georgia. and are in full operation, under charters incorporated under this law. And in view of the consequences any court might hesitate, unless the repugnance between the statute and the constitution was so palpable as to admit of no doubt, and produce a settled conviction of their incompatibility with each other.

4. It was formerly asserted that in England the act of incorporation must be the immediate act of the king himself, and that he could not grant a license to another to create a corporation. 10 Reports, 27. But Messrs. Angell and Ames, in their Treatise on Corporations, state that the law has since been settled to the contrary; and that the king may not only grant a license to a subject to erect a particular corporation, but give a general power by charter to erect corporations indefinitely, on the principle that *qui facit per alium facit per se*; that the persons to whom the power is delegated of establishing corporations, are only an instrument in the hands of the government. 1 Kyd, 50; 1 Black. Com.; Ang. & Am. 63.

Before the revolution charters of incorporation were granted by the proprietaries of Pennsylvania under a derivative authority from the Crown; and those charters have since been recognized as valid. 3 Wilson's Lectures, 409. A similar power has been delegated by the Legislature of Pennsylvania with regard to churches. 7 S. & R. 517. The acts of the instrument in these cases become the acts of the mover, under the familiar maxim above mentioned. See also 1 Mo. R. 5.

5. Our opinion is that no legislative power is delegated to the courts by the acts under consideration. There is simply a minis-

terial act to be performed,—no discretion is given the courts. The duty of passing the rule or order directing the petition of the corporators to be entered of record on the minutes of the court, setting forth to the public the object of the association and the privilege they desire to exercise, together with the name and style by which they are to be called and known, is made obligatory upon the courts; and should they refuse to discharge it, a mandamus would lie to coerce them. It is true the legislature has seen fit to use the courts for the purpose of giving legal form to these companies. But it might have been done in any other way. Under the Free Banking Law of 1838, instead of petitioning the court, and having the order passed and entered upon its minutes, the certificate specifying the name of the association, its place of doing business, the amount of its capital stock, the names and residence of the shareholders, and the time for which the company was organized, is required merely to be proven and acknowledged, and recorded in the office of the clerk of the superior court, where any office of the association is established, and a copy filed with the Comptroller General. Cobb's Digest, 107, 108.

And so under the act of 1847, authorizing the citizens of this state, and such others as they may associate with them, to prosecute the business of manufacturing with corporate powers and privileges. The persons who propose to embark in that branch of business are required to draw up a declaration specifying the objects of their association and the particular branch of business they intend carrying on, together with the name by which they will be known as a corporation, and the amount of capital to be employed by them; which declaration is required to be first recorded in the clerk's office of the superior court of the county where such corporation is located, and published once a week for two months in the two nearest gazettes; which being done, it is declared the said association shall become a body corporate and politic, and known as such, without being specially pleaded, in all courts of law and equity in this state, to be governed by the provisions and be subject to the liabilities therein specified. Cobb's Digest, 439, 440.

In these two instances, and others which might be cited, the legislature have dispensed with the action of the courts, or of any other agency, to carry out their enactments with regard to the various associations which have become the usual and favorite mode of conducting the industrial pursuits of the civilized world in modern times.

All these Statutes were complete as laws when they came from the hands of the legislature, and did not depend for their force and efficacy upon the action or will of any other power. It is



true that they could only take effect upon the happening of some event, such as the filing the petition or declaration, and giving publicity to the purpose of the association in the mode prescribed by the act. But if this were a good reason for regarding these statutes as invalid, then how few corporations could abide the test! For it requires the acceptance of the charter to create a corporate body; for the government cannot compel persons to become an incorporate body without their consent. And this consent, either express or implied, is generally subsequent in point of time to the creation of the charter. And yet, no charter that we are aware of has been adjudged invalid, because the law creating it and previously defining its powers, rights, capacities, and liabilities, did not take effect until the acceptance of the corporate body, or at least a majority of them, was signified.

The result therefore of our deliberation upon this case, is that the Acts of 1843 and 1845, vesting in all associations, except for banking and insurance, the power of self-incorporation, do not impugn the constitution, and that the charter of the Franklin Bridge Company and all others created under them, and in conformity to their provisions, are legal and valid. With the policy of these statutes we have nothing to do. The province of this and all other courts is *jus dicere*, not *jus dare*. *Judgment reversed*

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## STATE V. DAWSON.

SUPREME COURT OF INDIANA, 1861.

(16 Ind. 40.)

### *Acceptance of Charter.*

Perkins, J.: Information against the defendants, charging that they are pretending to be a corporation, and to act as such, when they are not a corporation. It charges that in January, 1849, the legislature of the state of Indiana enacted a special charter of incorporation, (which is set out at length) for a railroad from Fort Wayne, Indiana, to Jeffersonville, to be called the Fort Wayne and Southern Railroad; that the persons named in the charter as directors did not accept said charter till June 2, 1852, when they did meet and accept the same and organize under it. It is alleged that the defendants are assuming to act under said charter, never having organized under any other. The court below sustained a demurrer to the information; thus holding the defendants to be a legal corporation.

The present constitution of Indiana took effect on November 1, 1851. It contains these provisions:—

“All laws now in force and not inconsistent with this Constitution, shall remain in force, until they shall expire or be repealed.” Sched. (1 subsec.) of Const.

“Corporations, other than banking, shall not be created by special act, but may be formed under general laws.” Art. II. § 13.

“All acts of incorporation for municipal purposes shall continue in force under this Constitution, until such time as the General Assembly shall, in its discretion, modify or repeal the same.” Sched. *supra*, subsec. 4.

The charter for the Fort Wayne and Southern Railroad was not a charter for municipal purposes, and hence was not specially continued in existence. Art. II. § 13, above quoted, prohibits the creation of a corporation by special act or charter, that is, as we construe the prohibition, through, or by virtue of, such special act or charter, after November 1, 1851. The policy that induced the prohibition, as well as its literal import, demands this construction. It is necessary for us to ascertain, then, when the defendants, if ever, were created a corporation. The simple enactment of the charter for the corporation, by the legislature, did not create the corporation. It required one act on the part of the persons named in the charter to do that, viz.: acceptance of the charter enacted.

Says Grant, in his work on Corporations, vide p. 13, “Nor can a charter be forced on any body of persons who do not choose to accept it.” And again, at page 18, he says, “The fundamental rule is this: No charter of incorporation is of any effect until it is accepted by a majority of the grantees, or persons who are to be the corporators under it. *Bagg's Case*, 2 Brownl. & G. 100; s. c. 1 Roll. Rep. 224; *Dr. Askew's Case*, 4 Burr. 2200; *Rutter v. Chapman*, 8 M & W. 25; per *Wilmont, J.*, *Rex v. Vice-Chancellor of Cambridge*, 3 Burr. 1661. This is analogous to the general rule that a man cannot be obliged to accept the grant or devise of an estate. *Townson v. Tickell*, 3 B. & Ald. 31.” See, also, Ang. & Am. § 83, where it is said if a charter is granted to those who did not apply for it, the grant is said to be *in fieri* till acceptance. We need not inquire whether this rule extends to municipal corporations in this country. As to what may constitute an acceptance we are not here called on to decide, as the information expressly shows that there was none in this case till June, 1852, which fact is admitted by the demurrer.

The grant of the charter in question, then, to those who had not applied for it, was but an offer, on the part of the state; a consent that the persons named in the charter might become a

corporation, might be created such an artificial being, by accepting the charter offered. But an offer, till accepted, may be withdrawn. In this case, the offer made by the state, in 1849, was withdrawn by the state, November 1, 1851, by then declaring that no corporation, after that date, should be created except pursuant to regulations which she, in future, through her legislature would prescribe.

This pretended corporation, then, was not created before November 1, 1851, and it could be created afterward only by the concurrent consent of the state and the corporators. But at that date, the constitution prohibited both the state and corporators from giving consent to such a corporation, to wit: one coming into existence through a special charter; and hence necessarily prohibited the creation thereof. This decision accords with that of the supreme court of the United States in *Aspinwall v. Daviess County*, 22 How. 364; where it was held that the new constitution prohibited a subscription of stock to the Ohio and Mississippi Railroad Company, authorized by the charter of the corporation, granted under the former constitution, and actually voted by the people of the county under that constitution.

Whether, as a matter of fact, the charter in this case was accepted under the old constitution, must be determined on a trial of the cause below.

Had the provision in our constitution, like that on this subject in the constitution of Ohio, ordained that the legislature should "pass no special act conferring corporate powers," the restraint would clearly have been imposed alone upon future legislative action; but, in our constitution, the restraint is plainly imposed upon the creation, the organization, of the corporation itself. See *The State v. Roosa*, 11 Ohio St. 16.

PER CURIAM.—The judgment is reversed, with costs. Cause remanded for further proceedings in accordance with this opinion.

## CHAPTER III.

## DE FACTO AND IRREGULARLY ORGANIZED CORPORATIONS.

## FINNEGAN V. KNIGHTS OF LABOR BUILDING ASSOCIATION.

SUPREME COURT OF MINNESOTA, 1893.

(53 N. W. Rep. 1150.)

*De Facto Corporations.*

Gilfillan, C. J.: Eight persons signed, acknowledged, and caused to be filed and recorded in the office of the city clerk in Minneapolis, articles assuming and purporting to form, under Laws 1870, c. 29, a corporation, for the purpose, as specified in them, of "buying, owning, improving, selling and leasing, of lands, tenements, and hereditaments, real, personal, and mixed estates and property, including the construction and leasing of a building in the city of Minneapolis, Minn., as a hall to aid and carry out the general purposes of the organization known as the "Knights of Labor." The association received subscriptions to its capital stock, elected directors and a board of managers, adopted by-laws, bought a lot, erected a building on it, and, when completed, rented different parts of it to different parties. The plaintiff furnished plumbing for the building during its construction amounting to \$599.50, for which he brings this action against several subscribers to the stock, as copartners doing business under the firm name of the "K of L. Building Association." The theory upon which the action is brought is that, the association having failed to become a corporation, it is in law a partnership, and the members liable as partners for the debts incurred by it.

It is claimed that the association was not an incorporation because—*First*, the act under which it attempted to become incorporated, to wit, Laws 1870, c. 29, is void, because its subject is not properly expressed in the title; *second*, the act does not authorize the formation of corporations for the purpose or to transact the business stated in the articles; *third*, the place where the business was to be carried on was not distinctly stated in the articles, and they had, perhaps, some other minor defects.

It is unnecessary to consider whether this was a *de jure* corporation, so that it could defend against a *quo warranto*, or an action in the nature of *quo warranto*, in behalf of the state; for, although an association may not be able to justify itself when called on by the state to show by what authority it assumes to be, and act as, a corporation, it may be so far a corporation that, for reasons of public policy, no one but the state will be permitted to call in question the lawfulness of its organization. Such is what is termed a corporation *de facto*,—that is, a corporation from the fact of its acting as such, though not in law or of right a corporation. What is essential to constitute a body of men a *de facto* corporation is stated by SELDEN, J., in *Methodist, etc., Church v. Pickett*, 19 N. Y. 482, as “(1) the existence of a charter or some law under which a corporation with the powers assumed might lawfully be created; and (2) a user by the party to the suit of the rights claimed to be conferred by such charter or law.” This statement was apparently adopted by this court in *East Norway Church v. Froislie*, 37 Minn. 447, 35 N. W. Rep. 260; but, as it leaves out of account any attempt to organize under the charter or law, we think the statement of what is essential defective. The definition in *Taylor on Private Corporations* (page 145) is more nearly accurate; “When a body of men are acting as a corporation, under color of apparent organization, in pursuance of some charter or enabling act, their authority to act as a corporation cannot be questioned collaterally.” To give to a body of men assuming to act as a corporation, where there has been no attempt to comply with the provisions of any law authorizing them to become such, the *status* of a *de facto* corporation might open the door to frauds upon the public. It would certainly be impolitic to permit a number of men to have the *status* of a corporation to any extent merely because there is a law under which they might have become incorporated, and they have agreed among themselves to act, and they have acted, as a corporation. That was the condition in *Johnson v. Corser*, 34 Minn. 355, 25 N. W. Rep. 799, in which it was held that what had been done was ineffectual to limit the individual liability of the associates. They had not gone far enough to become a *de facto* corporation. They had merely signed articles, but had not attempted to give them publicity by filing for record, which the statute required. “Color of apparent organization under some charter or enabling act” does not mean that there shall have been a full compliance with what the law requires to be done, nor a substantial compliance. A substantial compliance will make a corporation *de jure*. But there must be an apparent attempt to perfect an organization under the law. There being such apparent attempt to perfect an

organization, the failure as to some substantial requirement will prevent the body being a corporation *de jure*; but, if there be user pursuant to such attempted organization, it will not prevent it being a corporation *de facto*.

The title to chapter 29 is "An act in relation to the formation of co-operative associations." Appellant's counsel argues that the body of the act does not contain a single element of "co-operation," as that term is generally understood. But how it is generally understood he does not inform us. In a broad sense, all associations, whether corporations or partnerships, are co-operative, for all the members, either by their labor or capital, or both, co-operate to a common purpose. There is undoubtedly, in popular use of the terms, a more limited sense, though the precise limits are not well defined. There is no legal, as distinguishable from their popular, signification. In the Century Dictionary the term "co-operative society" is defined, "A union of individuals, commonly laborers or small capitalists, formed \* \* \* for the prosecution in common of a productive enterprise, the profits being shared in accordance with the amount of capital or labor contributed by each member." Taking the distinctive feature of a co-operative society to be that it is made up of laborers or small capitalists, it is manifest that the chapter intends to deal with just that sort of associations. Not only does it contemplate that the operations of the corporations shall be local, but the capital stock is limited to \$50,000, the stock which one member may hold to \$1,000. No one can become a shareholder without the consent of the managers, and no one is entitled to more than one vote. The provisions in the body of the act are in accord with the title, and it is therefore not open to the objection made against it. The purposes for which, under the act, corporations may be formed, are "of trade, or of carrying on any lawful mechanical, manufacturing, or agricultural business." The main purpose of the act being to enable men of small capital, or of no capital but their labor and their skill in trades, to form corporations, for the purpose of giving employment to such capital or labor and skill, the language expressing the purposes for which such corporations may be formed ought not to be narrowly construed. Giving a reasonably liberal meaning to the word "trade" in the act, it would include the buying and selling of real estate, and, upon a similar construction the word "mechanical" would include the erection of buildings. The doing of the mason, or brick, or carpenter, or any other work upon a building is certainly mechanical. There can be little question that corporations might be formed to do either of those kinds of work on buildings, and, that being so, there is no reason why they may not be

formed to do all of them. There is no reason to claim that such a corporation must do its work as a contractor for some other person. It may do it for itself, and, as the act authorizes the corporation to "take, hold, and convey such real and personal estate as is necessary for the purposes of its organization," it may, instead of working for others as a contractor, make its profit by buying real estate, erecting buildings on it, and either selling or holding them for leasing. The omission to state distinctly in the articles the place within which the business is to be carried on, though that might be essential to make it a *de jure* corporation, would not prevent it becoming one *de facto*. The foundation for a *de facto* corporation having been laid by the attempt to organize under the law, the user shown was sufficient. Judgment affirmed.

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FOSTER V. MOULTON.

SUPREME COURT OF MINNESOTA, 1886.

(85 Minn. 458.)

*De Facto Corporation.*

Berry. J.: The complaint in this action sets out what purport to be the articles of incorporation of a mutual benefit association, which appears to have been intended to be a sort of mutual insurance company, and alleges that said articles were duly executed by defendants, and duly recorded with the register of deeds and secretary of state; that one McCarty became a member of the association, paid his dues and received a certificate of membership; that he sustained bodily injury entitling him, as such member, to pecuniary benefit; that the amount due him under the terms of his membership has not been paid; and that he has duly assigned his right to such benefit to the plaintiff.

The association did not comply with the statute so as to become an insurance corporation *de jure*. The appellant (one of the defendants) contends that it was duly incorporated as a benevolent society under Gen. St. 1878, c. 34, title 3. This cannot be so, for it is no more a *benevolent* society than any mutual insurance company, or other mutual company, or any partnership of which one member undertakes to do something for the pecuniary advantage of another member, in consideration of the undertaking of the latter to do a like thing for him. The undertaking is

not in a proper sense *benevolent*, but it is for a *quid pro quo*; it is paid for. *People v. Nelson*, 46 N. Y. 477. The association involved in the case at bar is, in substance, for purposes of *mutual insurance*. *State v. Merchants' Exch. Mut. Ben. Soc.*, 72 Mo. 146; *State v. Benefit Ass'n.*, 6 Mo. App. 163; *Com. v. Wetherbee*, 105 Mass. 149; May, Ins. § 550a.

But notwithstanding it is not a corporation *de jure*, we think it must, at least, as between its members, be regarded as a corporation *de facto*. It is manifest that the understanding between the members, and the basis upon which certificates of membership were issued, was that the association was a corporation in fact as it was in form. *Morawetz, Priv. Corp.* § 139. It never could have been intended or expected that the members of the association, whether original founders,—members like defendants,—or those who should become members by joining at any time, should or would be liable as individuals, either jointly or severally, to any particular member who should, by virtue of and under the terms of his membership, become entitled to pecuniary relief or benefit. On the contrary, the intention and the real contract was that the association, as a corporation in the contemplation of the parties, *i. e.*, the members, should be liable, and the association only. In such a state of facts, though the association is not a corporation *de jure*, and perhaps not for every purpose a corporation *de facto*, it is, as between the members themselves, to be treated as a corporation *de facto*, (for that is the way in which the contract of the parties treats it;) and the right of a member to pecuniary benefit from the association by virtue of his membership must stand upon the basis that it is a corporation *de facto*. Being presumed to know the significance of his membership, its rights and liabilities, (*Coles v. Iowa State Mut. Ins. Co.*, 18 Iowa, 425,) he is estopped to take any other position. This is not only intrinsically just and fair, but it is in accordance with the principles of the authorities. *Morawetz, Priv. Corp.* §§ 131, 132, 134–137; *Buffalo & A. R. Co. v. Cary*, 26 N. Y. 75, followed in 57, 64, 67, N. Y., and 95 U. S.; *White v. Ross*, 4 Abb. Dec. 589; *Aspinwall v. Sacchi*, 57 N. Y. 331; *Eaton v. Aspinwall*, 19 N. Y. 119; *Sands v. Hill*, 46 Barb. 651; *Sanger v. Upton*, 91 U. S. 56; *Chubb v. Upton*, 95 U. S. 665.

It is important to bear in mind that no fraud is alleged against defendant; and, further, that this is a case in which a member of the association is seeking relief by virtue of his membership. If the action were between a purported or pretended corporation, which was wholly unauthorized and invalid, and a stranger, different rules and principles might, in some circumstances, be involved.

The application of the foregoing views is that, the action hav-



ing been brought against defendants as individuals merely, the general demurrer of the appellant, who was one of the defendant members of the association, was erroneously overruled. The overruling order is accordingly reversed.

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RAILROAD COMPANY V. CARY.

NEW YORK COURT OF APPEALS, 1862.

(26 N. Y. 75.)

*De Facto Corporation—Estoppel.*

Masten, J.: The defendant contends that the plaintiff's organization is defective, because the affidavit annexed to the articles of association does not contain the allegation required by the statute, "that it is intended in good faith to construct or to maintain and operate the road mentioned in the articles of association," and that it is not therefore a corporation. The articles of association are in due form, and the affidavit annexed to them, while it does not come up to the requirement of the statute in the particular specified, is colorable. The articles and affidavit were filed and recorded in the office of the secretary of state; the capital stock was subscribed and partly paid in; the route of the road was surveyed and located; the right of way obtained; a contract for the construction of the whole road entered into, and liabilities incurred which have not been satisfied. This was sufficient to constitute the plaintiff a corporation *de facto*, so that neither it nor its stockholders can object that it is not strictly a corporation *de jure*.

I am of the opinion that, under this and similar general acts for the formation of corporations, if the papers filed, by which the corporation is sought to be created, are colorable, but so defective that, in a proceeding on the part of the state against it, it would for that reason be dissolved, yet by acts of user under such an organization it becomes a corporation *de facto*, and no advantage can be taken of such defect in its constitution, collaterally, by any person.

Any other rule, it seems to me, must be fraught with serious consequences and great public mischief. Most of the persons who subscribe in good faith for the stock do not examine to see whether all the requirements of the statute in the organization of the corporation have been complied with; and if they did examine

would not probably discover a defect like the one now pointed out. The stock is sold in market from hand to hand without any such examination. The corporation may carry on its business for years, and its stock have entirely changed hands, when its property may be destroyed by a trespasser, and in an action against him in the name of the corporation, his only defence, "you are not legally a corporation by reason of a defect in your constitution," would (upon the doctrine contended for by the defendant) be successful. The doctrine of estoppel could not be applied in that case, as it has been in some cases, to counteract an erroneous decision upon the question now before me.

I am aware that there are decisions in the supreme court, beginning with *The First Baptist Society v. Rapalee*, 16 Wend. 605, upon the point now presented to us, in conflict with the opinion I have here expressed. Their error is, in not recognizing the distinction between what is sufficient to constitute a corporation *de facto* and what is necessary to constitute one *de jure*, and how and by whom a corporation *de facto* may be shown not to be a corporation *de jure*. The state alone can take advantage of a defect in the constitution of a corporation like the one in this case. In its action it will be governed by public policy and considerations. And it has declared that it will not take advantage of the defect in the plaintiff's constitution. I think the court of appeals has settled the principle as I have stated it. *Eaton v. Aspinwall*, 19 N. Y. 119.

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## HEASTON V. RAILROAD COMPANY.

SUPREME COURT OF INDIANA, 1861.

(16 Ind. 275.)

### *De Facto Corporation—Estoppel.*

Perkins, J.: The Cincinnati and Fort Wayne Railroad Company sued David Heaston, on an alleged subscription to the capital stock of said company, of \$1,500. His subscription appears to the original articles of organization, and a copy of them is filed as the foundation of the action. The defendant answered in sixteen paragraphs. To a part of those paragraphs the plaintiff demurred; the court sustained the demurrer, the defendant excepted, and the cause was continued. At a subsequent term, the court permitted those demurrers to be with-

drawn, and others to be filed, argued and decided upon. \* \* \*

A corporation may sue in this state, in its corporate name, and need not aver in the complaint how it became a corporation, nor that it is such. And a default, or answer in denial of the cause of action, admits the capacity of the plaintiff to sue. *Harris vs. The Muskingum, &c., Co.* 4 Blackf. 267 and cases cited; *Hubbard vs. Chappel*, 14 Ind. 601.

But there may be an answer of *nul tiel* corporation, at the commencement of the suit. The cases *supra*; and *Morgan vs. Lawrenceburg, &c.* 3 Ind. 285; Ind. Dig. p. 318. Such answer, it is now settled in this state, is an answer in abatement, and must therefore precede answers to the merits. *Jones vs. The Cincinnati, &c. Co.*, 14 Ind. 89; *McIntyre vs. Preston*, 5 Gil. (Ill.) 48, *Phoenix, Bank &c. Curtiss*, 14 Conn. 437. And upon the trial of an issue of fact on such answer, or on a reply thereto, the proof is limited to the question of the existence, *de facto*, of a corporation, under an authority sanctioning such a corporation, *de jure*. In other words, mere irregularities in organization cannot be shown collaterally, where there is no defect of power. *The Bank of Toledo vs. The International Bank*, 21 N. Y. 542. and the authorities *supra*. See the cases cited in Abb. Pl. (N. Y.) p. 179; also *Ewing vs. Robeson et al.*, 15 Ind. 26. And where such answer denies the existence at the commencement of the suit, of a corporation which is shown to have once existed, the answer should particularly set forth the manner in which the corporate powers ceased. Ind. Dig. § 63, p. 319. A faulty answer in this respect was erroneously held good in *Morgan vs. Lawrenceburg, &c.* 3 Ind. *supra*.

We have asserted above, that the issue of *nul tiel* corporation is upon the existence of a *de facto* corporation, where one *de jure* is authorized; and upon this fact rests the doctrine of estoppel to deny the existence of a corporation, in certain cases. The estoppel goes to the mere *de facto* organization, not to the question of legal authority to make an organization. A *de facto* corporation that by regularity of organization might be one *de jure*, can sue and be sued. And a person who contracts with such corporation, while it is acting under its *de facto* organization, who contracts with it as an organized corporation, is estopped, in a suit on such contract, to deny its *de facto* organization at the date of the contract; but this does not extend to the question of legal power to organize. Hence, if an organization is completed where there is no law, or an unconstitutional law, authorizing an organization as a corporation, the doctrine of estoppel does not apply. *Harriman vs. Southam*, 16 Ind. 190; *Brown et al vs. Killian*, 11 Ind. 449. See 15 id. 395. So, if the plaintiff suing in a name importing *prima facie* a corporation, in fact it is not

assuming to act as a corporation, but only as a partnership, this fact may be raised by an answer alleging want of parties in interest to the suit. *Farnsworth vs. Drake*, 11 Ind. 101. See *Brown vs. Killian*, (*supra*). The sixteenth paragraph of the answer averred the non-performance of a condition precedent by the corporation, it having failed to tender to the defendant a certificate of stock. The paragraph was bad. *The New Albany Co. vs. McCormick*, 10 Ind. 499. \* \* \*

Considering the amount recovered in this case, the circumstances attending the trial, the evidence given, and that which was absent, and all the surroundings, we think the court should have sustained the motion that was made for a new trial.

PER CURIAM:—The judgment is reversed, with costs. Cause remanded, with leave to amend, &c.

## CHAPTER IV.

## THE CHARTER.

## LEGISLATIVE CONTROL UNDER THE CONSTITUTION.

## TRUSTEES OF DARTMOUTH COLLEGE V. WOODWARD.\*

SUPREME COURT OF THE UNITED STATES, 1819.

(4 *Wheat.* 517.)*Power of the Legislature Over Corporations.*

Marshall, C. J.: This is an action of trover, brought by the trustees of Dartmouth College against William H. Woodward, in the State Court of New Hampshire, for the books of records, corporate seal, and other corporate property, to which the plaintiffs allege themselves to be entitled.

A special verdict, after setting out the rights of the parties, finds for the defendant, if certain acts of the legislature of New Hampshire, passed on the 27th of June and on the 18th of December, 1816, be valid and binding on the trustees without their assent, and not repugnant to the constitution of the United States; otherwise, it finds for the plaintiffs.

The Superior Court of Judicature of New Hampshire rendered a judgment upon this verdict for the defendant, which judgment has been brought before this court by writ of error. The single question now to be considered is, do the acts to which the verdict refers violate the constitution of the United States?

This court can be insensible neither to the magnitude nor delicacy of this question. The validity of a legislative act is to be examined, and the opinion of the highest law tribunal of a state is to be revised; an opinion which carries with it intrinsic evidence of the diligence, of the ability and the integrity with which it was formed. On more than one occasion this court has expressed the cau-

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\*As to the legislative control over corporations, see *Charles River Bridge Co. v. Warren*, 11 Pet. (U. S.) 420 (1837); *Thorpe v. Railroad Co.*, 27 Vt. 140 (1855); *Greenwood v. Freight Co.*, 105 U. S. 18 (1881); *Commonwealth v. Eastern R. Co.*, 103 Mass. 254 (1869); *Railway Co. v. Lackey*, 78 Ill. 55 (1875); *Commonwealth v. Essex Co.*, 18 Gray. (Mass.) 289 (1859); *Detroit v. Plank Road Co.*, 43 Mich. 140 (1880).

tious circumspection with which it approaches the consideration of such questions, and has declared that in no doubtful case would it pronounce a legislative act to be contrary to the constitution. But the American people have said, in the constitution of the United States, that "no state shall pass any bill of attainder, *ex post facto* law, or law impairing the obligation of contracts." In the same instrument they have also said "that the judicial power shall extend to all cases in law and equity arising under the constitution." On the judges of this court, then, is imposed the high and solemn duty of protecting, from even legislative violation, those contracts which the constitution of our country has placed beyond legislative control, and, however irksome the task may be, this is a duty from which we dare not shrink.

The title of the plaintiffs originates in a charter dated the 13th day of December, in the year 1769, incorporating twelve persons therein mentioned, by the name of "The Trustees of Dartmouth College," granting to them and their successors the usual corporate privileges and powers, and authorizing the trustees, who are to govern the college, to fill up all vacancies which may be created in their own body.

The defendant claims under three acts of the legislature of New Hampshire, the most material of which was passed on the 27th of June, 1816, and is entitled "An act to amend the charter, and enlarge and improve the corporation of Dartmouth College." Among other alterations in the charter, this act increases the number of trustees to twenty-one, gives the appointment of the additional members to the executive of the state, and creates a board of overseers, with power to inspect and control the most important acts of the trustees. This board consists of twenty-five persons. The president of the senate, the speaker of the house of representatives, of New Hampshire, and the governor and lieutenant-governor of Vermont, for the time being, are to be members *ex-officio*. The board is to be completed by the governor and council of New Hampshire, who are also empowered to fill all vacancies which may occur. The acts of the 18th and 26th of December are supplemental to that of the 27th of June, and are principally intended to carry that act into effect.

The majority of the trustees of the college have refused to accept this amended charter, and have brought this suit for the corporate property, which is in possession of a person holding by virtue of the acts which have been stated.

It can require no argument to prove that the circumstances of this case constitute a contract. An application is made to the crown for a charter to incorporate a religious and literary institution. In the application it is stated that large contributions have been made for the object, which will be conferred on the corp-

oration as soon as it shall be created. The charter is granted, and on its faith the property is conveyed. Surely in this transaction every ingredient of a complete and legitimate contract is to be found.

The points for consideration are:

1. Is this contract protected by the constitution of the United States?

2. Is it impaired by the acts under which the defendant holds?

1. On the first point it has been argued that the word "contract," in its broadest sense, would comprehend the political relations between the government and its citizens, would extend to offices held within a state for state purposes, and to many of those laws concerning civil institutions which must change with circumstances and be modified by ordinary legislation; which deeply concern the public, and which, to preserve good government, the public judgment must control; that even marriage is a contract, and its obligations are affected by the laws respecting divorces; that the clause in the constitution, if construed in its greatest latitude, would prohibit these laws. Taken in its broad, unlimited sense, the clause would be an unprofitable and vexatious interference with the internal concerns of a state, would unnecessarily and unwisely embarrass its legislation, and render immutable those civil institutions which are established for purposes of internal government, and which, to subserve those purposes, ought to vary with varying circumstances. That as the framers of the constitution could never have intended to insert in that instrument a provision so unnecessary, so mischievous, and so repugnant to its general spirit, the term "contract" must be understood in a more limited sense. That it must be understood as intended to guard against a power of at least doubtful utility, the abuse of which had been extensively felt, and to restrain the legislature in future from violating the right to property. That anterior to the formation of the constitution a course of legislation had prevailed in many, if not in all, of the states, which weakened the confidence of man in man and embarrassed all transactions between individuals by dispensing with a faithful performance of engagements. To correct this mischief, by restraining the power which produced it, the state legislatures were forbidden "to pass any law impairing the obligation of contracts," that is, of contracts respecting property, under which some individual could claim a right to something beneficial to himself; and that, since the clause in the constitution must in construction receive some limitation, it may be confined, and ought to be confined, to cases of this description; to cases within the mischief it was intended to remedy.

The general correctness of these observations cannot be controverted. That the framers of the constitution did not intend to

restrain the states in the regulation of their civil institutions, adopted for internal government, and that the instrument they have given us is not to be so construed, may be admitted. The provision of the constitution never has been understood to embrace other contracts than those which respect property, or some object of value, and confer rights which may be asserted in a court of justice. It never has been understood to restrict the general right of the legislature, to legislate on the subject of divorces. Those acts enable some tribunals, not to impair a marriage contract, but to liberate one of the parties because it has been broken by the other. When any state legislature shall pass an act annulling all marriage contracts, or allowing either party to annul it without the consent of the other, it will be time enough to inquire whether such an act be constitutional.

The parties in this case differ less on general principles, less on the true construction of the constitution in the abstract, than on the application of those principles to this case, and on the true construction of the charter of 1769. This is the point on which the cause essentially depends. If the act of incorporation be a grant of political power, if it create a civil institution to be employed in the administration of the government, or if the funds of the college be public property, or if the state of New Hampshire, as a government, be alone interested in its transactions, the subject is one in which the legislature of the state may act according to its own judgment, unrestrained by any limitation of its power imposed by the constitution of the United States.

But if this be a private eleemosynary institution, endowed with a capacity to take property for objects unconnected with government, whose funds are bestowed by individuals on the faith of the charter; if the donors have stipulated for the future disposition and management of those funds in the manner prescribed by themselves, there may be more difficulty in the case, although neither the persons who have made these stipulations nor those for whose benefit they were made should be parties to the cause. Those who are no longer interested in the property may yet retain such an interest in the preservation of their own arrangements as to have a right to insist that those arrangements shall be held sacred. Or, if they have themselves disappeared, it becomes a subject of serious and anxious inquiry whether those whom they have legally empowered to represent them forever may not assert all the rights which they possessed while in being; whether, if they be without personal representatives who may feel injured by a violation of the compact, the trustees be not so completely their representatives, in the eye of the law, as to stand in their place, not only as respects the government of the college, but also as respects the maintenance of the college charter.



It becomes, then, the duty of the court most seriously to examine this charter, and to ascertain its true character.

From the instrument itself it appears that about the year 1754 the Rev. Eleazar Wheelock established, at his own expense and on his own estate, a charity school for the instruction of Indians in the Christian religion. The success of this institution inspired him with the design of soliciting contributions in England for carrying on and extending his undertaking. In this pious work he employed the Rev. Nathaniel Whitaker, who, by virtue of a power of attorney from Dr. Wheelock, appointed the Earl of Dartmouth and others trustees of the money which had been, and should be, contributed, which appointment Dr. Wheelock confirmed by a deed of trust authorizing the trustees to fix on a site for the college. They determined to establish the school on Connecticut river, in the western part of New Hampshire, that situation being supposed favorable for carrying on the original design among the Indians, and also for promoting learning among the English; and the proprietors in the neighborhood having made large offers of land on condition that the college should there be placed. Dr. Wheelock then applied to the crown for an act of incorporation, and represented the expediency of appointing those whom he had, by his last will, named as trustees in America, to be members of the proposed corporation. "In consideration of the premises," "for the education and instruction of the youth of the Indian tribes," etc., "and also of English youth and any others," the charter was granted, and the trustees of Dartmouth college were by that name created a body corporate, with power, for the use of the said college, to acquire real and personal property, and to pay the president, tutors and other officers of the college such salaries as they shall allow.

The charter proceeds to appoint Eleazer Wheelock, "the founder of said college," president thereof, with power by his last will to appoint a successor, who is to continue in office until disapproved by the trustees. In case of vacancy the trustees may appoint a president, and in case of the ceasing of a president the senior professor or tutor, being one of the trustees, shall exercise the office until an appointment shall be made. The trustees have power to appoint and displace professors, tutors, and other officers, and to supply any vacancies which may be created in their own body by death, resignation, removal, or disability; and also to make orders, ordinances and laws for the government of the college, the same not being repugnant to the laws of Great Britain or of New Hampshire, and not excluding any person on account of his speculative sentiments in religion, or his being of a religious profession different from that of the trustees.

This charter was accepted, and the property, both real and personal, which had been contributed for the benefit of the college, was conveyed to, and vested in, the corporate body.

From this brief review of the most essential parts of the charter it is apparent that the funds of the college consisted entirely of private donations. It is, perhaps, not very important who were the donors. The probability is that the Earl of Dartmouth and the other trustees in England were, in fact, the largest contributors. Yet the legal conclusion from the facts recited in the charter would probably be that Dr. Wheelock was the founder of the college.

The origin of the institution was, undoubtedly, the Indian charity school established by Dr. Wheelock, at his own expense. It was at his instance, and to enlarge this school, that contributions were solicited in England. The person soliciting these contributions was his agent, and the trustees, who received the money, were appointed by, and act under, his authority. It is not too much to say that the funds were obtained by him, in trust, to be applied by him to the purposes of his enlarged school. The charter of incorporation was granted at his instance. The persons named by him in his last will, as the trustees of his charity school, compose a part of the corporation, and he is declared to be the founder of the college, and its president for life. Were the inquiry material, we should feel some hesitation in saying that Dr. Wheelock was not, in law, to be considered as the founder (1 Bl. Com. 481) of this institution, and as possessing all the rights appertaining to that character. But be this as it may, Dartmouth college is really endowed by private individuals, who have bestowed their funds for the propagation of the Christian religion among the Indians, and for the promotion of piety and learning generally. From these funds the salaries of the tutors are drawn, and these salaries lessen the expense of education to the students. It is, then, an eleemosynary, (1 Bl. Com. 471) and, so far as respects its funds, a private corporation.

Do its objects stamp on it a different character? Are the trustees and professors public officers, invested with any portion of political power, partaking in any degree in the administration of civil government, and performing duties which flow from the sovereign authority?

That education is an object of national concern, and a proper subject of legislation, all admit. That there may be an institution founded by government, and placed entirely under its immediate control, the officers of which would be public officers, amenable exclusively to government, none will deny. But is Dartmouth college such an institution? Is education altogether in the hands of government? Does every teacher of youth become a public

officer, and do donations for the purpose of education necessarily become public property, so far that the will of the legislature, not the will of the donor, becomes the law of the donation? These questions are of serious moment to society, and deserve to be well considered.

Dr. Wheelock, as the keeper of his charity school, instructing the Indians in the art of reading, and in our holy religion, sustaining them at his own expense, and on the voluntary contributions of the charitable, could scarcely be considered as a public officer, exercising any portion of those duties which belong to government; nor could the legislature have supposed that his private funds, or those given by others, were subject to legislative management, because they were applied to the purposes of education. When, afterwards, his school was enlarged, and the liberal contributions made in England and in America enabled him to extend his cares to the education of the youth of his own country, no change was wrought in his own character or in the nature of his duties. Had he employed assistant tutors with the funds contributed by others, or had the trustees in England established a school with Dr. Wheelock at its head, and paid salaries to him and his assistants, they would still have been private tutors, and the fact that they were employed in the education of youth could not have converted them into public officers, concerned in the administration of public duties, or have given the legislature a right to interfere in the management of the fund. The trustees, in whose care that fund was placed by the contributors, would have been permitted to execute their trust uncontrolled by legislative authority.

Whence, then, can be derived the idea that Dartmouth college has become a public institution, and its trustees public officers, exercising powers conferred by the public for public objects? Not from the source whence its funds were drawn, for its foundation is purely private and eleemosynary. Not from the application of those funds, for money may be given for education, and the persons receiving it do not, by being employed in the education of youth, become members of the civil government. Is it from the act of incorporation? Let this subject be considered.

A corporation is an artificial being, invisible, intangible, and existing only in contemplation of law. Being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence. These are such as are supposed best calculated to effect the object for which it was created. Among the most important are immortality, and, if the expression may be allowed, individuality; properties by which a perpetual succession of many persons are considered as the same, and may act as a single individual. They enable a corporation to manage its own affairs,

and to hold property without the perplexing intricacies, the hazardous and endless necessity, of perpetual conveyances for the purpose of transmitting it from hand to hand. It is chiefly for the purpose of clothing bodies of men, in succession, with these qualities and capacities that corporations were invented, and are in use. By these means a perpetual succession of individuals are capable of acting for the promotion of the particular object, like one immortal being. But this being does not share in the civil government of the country, unless that be the purpose for which it was created. Its immortality no more confers on it political power, or a political character, than immortality would confer such power or character on a natural person. It is no more a state instrument than a natural person exercising the same powers would be. If, then, a natural person, employed by individuals in the education of youth, or for the government of a seminary in which youth is educated, would not become a public officer, or be considered as a member of the civil government, how is it that this artificial being, created by law for the purpose of being employed by the same individuals for the same purposes, should become a part of the civil government of the country? Is it because its existence, its capacities, its powers, are given by law? Because the government has given it the power to take and to hold property in a particular form, and for particular purposes, has the government a consequent right substantially to change that form, or to vary the purposes to which the property is to be applied? This principle has never been asserted or recognized, and is supported by no authority. Can it derive aid from reason?

The objects for which a corporation is created are universally such as the government wishes to promote. They are deemed beneficial to the country, and this benefit constitutes the consideration, and, in most cases, the sole consideration of the grant. In most eleemosynary institutions the object would be difficult, perhaps unattainable, without the aid of a charter of incorporation. Charitable or public spirited individuals, desirous of making permanent appropriations for charitable or other useful purposes, find it impossible to effect their design securely, and certainly, without an incorporating act. They apply to the government, state their beneficent object, and offer to advance the money necessary for its accomplishment, provided the government will confer on the instrument which is to execute their designs the capacity to execute them. The proposition is considered and approved. The benefit to the public is considered as an ample compensation for the faculty it confers, and the corporation is created. If the advantages to the public constitute a full compensation for the faculty it gives, there can be no reason for exacting a further compensation by claiming a right to exercise over this artificial

being a power which changes its nature, and touches the fund, for the security and application of which it was created. There can be no reason for implying in a charter, given for a valuable consideration, a power which is not only not expressed, but is in direct contradiction to its express stipulations.

From the fact, then, that a charter of incorporation has been granted, nothing can be inferred which changes the character of the institution, or transfers to the government any new power over it. The character of civil institutions does not grow out of their incorporation, but out of the manner in which they are formed, and the objects for which they are created. The right to change them is not founded on their being incorporated, but on their being the instruments of government, created for its purposes. The same institutions, created for the same objects, though not incorporated, would be public institutions, and, of course, be controllable by the legislature. The incorporating act neither gives nor prevents this control. Neither, in reason, can the incorporating act change the character of a private eleemosynary institution.

We are next led to the inquiry, for whose benefit the property given to Dartmouth college was secured. The counsel for the defendant have insisted that the beneficial interest is in the people of New Hampshire. The charter, after reciting the preliminary measures which had been taken, and the application for an act of incorporation, proceeds thus: "Know ye, therefore, that we, considering the premises, and being willing to encourage the laudable and charitable design of spreading Christian knowledge among the savages of our American wilderness, and, also, that the best means of education be established, in our province of New Hampshire, for the benefit of said province, do, of our special grace," etc. Do these expressions bestow on New Hampshire any exclusive right to the property of the college, any exclusive interest in the labors of the professors? Or do they merely indicate a willingness that New Hampshire should enjoy those advantages which result to all from the establishment of a seminary of learning in the neighborhood? On this point we think it impossible to entertain a serious doubt. The words themselves, unexplained by the context, indicate that the "benefit intended for the province" is that which is derived from "establishing the best means of education therein;" that is, from establishing in the province Dartmouth college, as constituted by the charter. But, if these words, considered alone, could admit of doubt, that doubt is completely removed by an inspection of the entire instrument.

The particular interests of New Hampshire never entered into the mind of the donors, never constituted a motive for their donation. The propagation of the Christian religion among the

savages, and the dissemination of useful knowledge among the youth of the country, were the avowed and the sole objects of their contributions. In these New Hampshire would participate; but nothing particular or exclusive was intended for her. Even the site of the college was selected, not for the sake of New Hampshire, but because it was "most subservient to the great ends in view," and because liberal donations of land were offered by the proprietors on condition that the institution should be there established. The real advantages from the location of the college are, perhaps, not less considerable to those on the west than to those on the east side of Connecticut river. The clause which constitutes the incorporation, and expresses the objects for which it was made, declares those objects to be the instruction of the Indians, "and also of English youth, and any others." So that the objects of the contributors and the incorporating act were the same; the promotion of Christianity and of education generally, not the interests of New Hampshire particularly.

From this review of the charter it appears that Dartmouth college is an eleemosynary institution, incorporated for the purpose of perpetuating the application of the bounty of the donors to the specified objects of that bounty; that its trustees or governors were originally named by the founder, and invested with the power of perpetuating themselves; that they are not public officers, nor is it a civil institution, participating in the administration of government; but a charity school, or a seminary of education, incorporated for the preservation of its property, and the perpetual application of that property to the objects of its creation.

Yet a question remains to be considered, of more real difficulty, on which more doubt has been entertained than on all that have been discussed. The founders of the college, at least those whose contributions were in money, have parted with the property bestowed upon it, and their representatives have no interest in that property. The donors of land are equally without interest so long as the corporation shall exist. Could they be found, they are unaffected by any alteration in its constitution, and probably regardless of its form, or even of its existence. The students are fluctuating, and no individual among our youth has a vested interest in the institution which can be asserted in a court of justice. Neither the founders of the college nor the youth for whose benefit it was founded complain of the alteration made in its charter, or think themselves injured by it. The trustees alone complain, and the trustees have no beneficial interest to be protected. Can this be such a contract as the constitution intended to withdraw from the power of state legislation? Contracts, the parties to which have a vested beneficial interest, and those only, it has been said,

are the objects about which the constitution is solicitous, and to which its protection is extended.

The court has bestowed on this argument the most deliberate consideration, and the result will be stated. Dr. Wheelock, acting for himself, and for those who, at his solicitation, had made contributions to his school, applied for this charter, as the instrument which should enable him, and them, to perpetuate their beneficent intention. It was granted. An artificial, immortal being was created by the crown, capable of receiving and distributing forever, according to the will of the donors, the donations which should be made to it. On this being the contributions which had been collected were immediately bestowed. These gifts were made, not, indeed, to make a profit for the donors or their posterity, but for something in their opinion of inestimable value; for something which they deemed a full equivalent for the money with which it was purchased. The consideration for which they stipulated is the perpetual application of the fund to its object, in the mode prescribed by themselves. Their descendants may take no interest in the preservation of this consideration. But in this respect their descendants are not their representatives. They are represented by the corporation. The corporation is the assignee of their rights, stands in their place, and distributes their bounty as they would themselves have distributed it had they been immortal. So with respect to the students who are to derive learning from this source. The corporation is a trustee for them also. Their potential rights, which, taken distributively, are imperceptible, amount collectively to a most important interest. These are, in the aggregate, to be exercised, asserted, and protected by the corporation. They were as completely out of the donors at the instant of their being vested in the corporation, and as incapable of being asserted by the students, as at present.

According to the theory of the British constitution, their parliament is omnipotent. To annul corporate rights might give a shock to public opinion, which that government has chosen to avoid, but its power is not questioned. Had parliament, immediately after the emanation of this charter, and the execution of those conveyances which followed it, annulled the instrument, so that the living donors would have witnessed the disappointment of their hopes, the perfidy of the transaction would have been universally acknowledged. Yet then, as now, the donors would have had no interest in the property; then, as now, those who might be students would have had no rights to be violated; then, as now, it might be said that the trustees, in whom the rights of all were combined, possessed no private, individual, beneficial interest in the property confided to their protection. Yet the contract would at that time have been deemed sacred by all. What has since

occurred to strip it of its inviolability? Circumstances have not changed it. In reason, in justice, and in law it is now what it was in 1769.

This is plainly a contract to which the donors, the trustees, and the crown (to whose rights and obligations New Hampshire succeeds) were the original parties. It is a contract made on a valuable consideration. It is a contract for the security and disposition of property. It is a contract on the faith of which real and personal estate has been conveyed to the corporation. It is then a contract within the letter of the constitution, and within its spirit also, unless the fact that the property is invested by the donors in trustees for the promotion of religion and education, for the benefit of persons who are perpetually changing, though the objects remain the same, shall create a particular exception, taking this case out of the prohibition contained in the constitution.

It is more than possible that the preservation of rights of this description was not particularly in the view of the framers of the constitution when the clause under consideration was introduced into that instrument. It is probable that interferences of more frequent recurrence, to which the temptation was stronger, and of which the mischief was more extensive, constituted the great motive for imposing this restriction on the state legislatures. But although a particular and a rare case may not, in itself, be of sufficient magnitude to induce a rule, yet it must be governed by the rule, when established, unless some plain and strong reason for excluding it can be given. It is not enough to say that this particular case was not in the mind of the convention when the article was framed, nor of the American people when it was adopted. It is necessary to go farther, and to say that, had this particular case been suggested, the language would have been so varied as to exclude it, or it would have been made a special exception. The case being within the words of the rule, must be within its operation likewise, unless there be something in the literal construction so obviously absurd, or mischievous, or repugnant to the general spirit of the instrument, as to justify those who expound the constitution in making it an exception.

On what safe and intelligible ground can this exception stand? There is no expression in the constitution, no sentiment delivered by its contemporaneous expounders, which would justify us in making it. In the absence of all authority of this kind, is there, in the nature and reason of the case itself, that which would sustain a construction of the constitution not warranted by its words? Are contracts of this description of a character to excite so little interest that we must exclude them from the provisions of the constitution as being unworthy of the attention of those who



framed the instrument? Or does public policy so imperiously demand their remaining exposed to legislative alteration as to compel us, or rather permit us, to say that these words, which were introduced to give stability to contracts, and which in their plain import comprehend this contract, must yet be so construed as to exclude it?

Almost all eleemosynary corporations, those which are created for the promotion of religion, of charity, or of education, are of the same character. The law of this case is the law of all. In every literary or charitable institution, unless the objects of the bounty be themselves incorporated, the whole legal interest is in trustees, and can be asserted only by them. The donors or claimants of the bounty, if they can appear in court at all, can appear only to complain of the trustees. In all other situations they are identified with, and personated by, the trustees, and their rights are to be defended and maintained by them. Religion, charity and education are, in the law of England, legatees or donees, capable of receiving bequests or donations in this form. They appear in court, and claim or defend by the corporation. Are they of so little estimation in the United States that contracts for their benefit must be excluded from the protection of words which, in their natural import, include them? Or do such contracts so necessarily require new modeling by the authority of the legislature that the ordinary rules of construction must be disregarded in order to leave them exposed to legislative alteration?

All feel that these objects are not deemed unimportant in the United States. The interest which this case has excited proves that they are not. The framers of the constitution did not deem them unworthy of its care and protection. They have, though in a different mode, manifested their respect for science by reserving to the government of the Union the power "to promote the progress of science and useful arts by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries." They have so far withdrawn science and the useful arts from the action of the state governments. Why, then, should they be supposed so regardless of contracts made for the advancement of literature as to intend to exclude them from provisions made for the security of ordinary contracts between man and man? No reason for making this supposition is perceived.

If the insignificance of the object does not require that we should exclude contracts respecting it from the protection of the constitution, neither, as we conceive, is the policy of leaving them subject to legislative alteration so apparent as to require a forced construction of that instrument in order to effect it. These eleemosynary institutions do not fill the place which would otherwise

be occupied by government, but that which would otherwise remain vacant. They are complete acquisitions to literature. They are donations to education, donations which any government must be disposed rather to encourage than to discountenance. It requires no very critical examination of the human mind to enable us to determine that one great inducement to these gifts is the conviction felt by the giver that the disposition he makes of them is immutable. It is probable that no man ever was, and that no man ever will be, the founder of a college, believing at the time that an act of incorporation constitutes no security for the institution; believing that it is immediately to be deemed a public institution, whose funds are to be governed and applied, not by the will of the donor, but by the will of the legislature. All such gifts are made in the pleasing, perhaps delusive, hope that the charity will flow forever in the channel which the givers have marked out for it. If every man finds in his own bosom strong evidence of the universality of this sentiment, there can be but little reason to imagine that the framers of our constitution were strangers to it, and that, feeling the necessity and policy of giving permanence and security to contracts, of withdrawing them from the influence of legislative bodies, whose fluctuating policy and repeated interferences produced the most perplexing and injurious embarrassments, they still deemed it necessary to leave these contracts subject to those interferences. The motives for such an exception must be very powerful to justify the construction which makes it.

The motives suggested at the bar grow out of the original appointment of the trustees, which is supposed to have been in a spirit hostile to the genius of our government, and the presumption that, if allowed to continue themselves, they now are, and must remain forever, what they originally were. Hence is inferred the necessity of applying to this corporation, and to other similar corporations, the correcting and improving hand of the legislature.

It has been urged repeatedly, and certainly with a degree of earnestness which attracted attention, that the trustees, deriving their power from a regal source, must necessarily partake of the spirit of their origin, and that their first principles, unimproved by that resplendent light which has been shed around them, must continue to govern the college and to guide the students. Before we inquire into the influence which this argument ought to have on the constitutional question, it may not be amiss to examine the fact on which it rests. The first trustees were undoubtedly named in the charter by the crown, but at whose suggestion were they named? By whom were they selected? The charter informs

us. Dr. Wheelock had represented "that, for many weighty reasons, it would be expedient that the gentlemen whom he had already nominated in his last will to be trustees in America should be of the corporation now proposed." When, afterwards, the trustees are named in the charter, can it be doubted that the persons mentioned by Dr. Wheelock in his will were appointed? Some were probably added by the crown, with the approbation of Dr. Wheelock. Among these is the doctor himself. If any others were appointed at the instance of the crown, they are the governor, three members of the council, and the speaker of the house of representatives of the colony of New Hampshire. The stations filled by these persons ought to rescue them from any other imputation than too great a dependence on the crown. If, in the revolution that followed, they acted under the influence of this sentiment, they must have ceased to be trustees; if they took part with their countrymen, the imputation which suspicion might excite would no longer attach to them. The original trustees, then, or most of them, were named by Dr. Wheelock, and those who were added to his nomination, most probably with his approbation, were among the most eminent and respectable individuals in New Hampshire.

The only evidence which we possess of the character of Dr. Wheelock is furnished by this charter. The judicious means employed for the accomplishment of his object, and the success which attended his endeavors, would lead to the opinion that he united a sound understanding to that humanity and benevolence which suggested his undertaking. It surely cannot be assumed that his trustees were selected without judgment. With as little probability can it be assumed that, while the light of science and of liberal principles pervades the whole community, these originally benighted trustees remain in utter darkness, incapable of participating in the general improvement; that, while the human race is rapidly advancing, they are stationary. Reasoning *a priori*, we should believe that learned and intelligent men, selected by its patrons for the government of a literary institution, would select learned and intelligent men for their successors; men as well fitted for the government of a college as those who might be chosen by other means. Should this reasoning ever prove erroneous in a particular case, public opinion, as has been stated at the bar, would correct the institution. The mere possibility of the contrary would not justify a construction of the constitution which should exclude these contracts from the protection of a provision whose terms comprehend them.

The opinion of the court, after mature deliberation, is that this is a contract, the obligation of which cannot be impaired without violating the constitution of the United States. This opinion ap-

pears to us to be equally supported by reason and by the former decisions of this court.

2. We next proceed to the inquiry whether its obligation has been impaired by those acts of the legislature of New Hampshire to which the special verdict refers.

From the review of this charter which has been taken it appears that the whole power of governing the college, of appointing and removing tutors, of fixing their salaries, of directing the course of study to be pursued by the students, and of filling up vacancies created in their own body, was vested in the trustees. On the part of the crown it was expressly stipulated that this corporation, thus constituted, should continue forever, and that the number of trustees should forever consist of twelve, and no more. By this contract the crown was bound, and could have made no violent alteration in its essential terms without impairing its obligation.

By the revolution the duties, as well as the powers, of government devolved on the people of New Hampshire. It is admitted that among the latter was comprehended the transcendent power of parliament, as well as that of the executive department. It is too clear to require the support of argument that all contracts and rights respecting property remained unchanged by the revolution. The obligations, then, which were created by the charter to Dartmouth college were the same in the new that they had been in the old government. The power of the government was also the same. A repeal of this charter at any time prior to the adoption of the present constitution of the United States would have been an extraordinary and unprecedented act of power, but one which could have been contested only by the restrictions upon the legislature to be found in the constitution of the state. But the constitution of the United States has imposed this additional limitation, that the legislature of a state shall pass no act "impairing the obligation of contracts."

It has been already stated that the act "to amend the charter, and enlarge and improve the corporation of Dartmouth college," increases the number of trustees to twenty-one, gives the appointment of the additional members to the executive of the state, and creates a board of overseers, to consist of twenty-five persons, of whom twenty-one are also appointed by the executive of New Hampshire, who have power to inspect and control the most important acts of the trustees.

On the effect of this law two opinions cannot be entertained. Between acting directly and acting through the agency of trustees and overseers no essential difference is perceived. The whole power of governing the college is transferred from trustees appointed according to the will of the founder, expressed in the char-

ter, to the executive of New Hampshire. The management and application of the funds of this eleemosynary institution, which are placed by the donors in the hands of trustees named in the charter, and empowered to perpetuate themselves, are placed by this act under the control of the government of the state. The will of the state is substituted for the will of the donors in every essential operation of the college. This is not an immaterial change. The founders of the college contracted not merely for the perpetual application of the funds which they gave to the objects for which those funds were given; they contracted also to secure that application by the constitution of the corporation. They contracted for a system which should, as far as human foresight can provide, retain forever the government of the literary institution they had formed in the hands of persons approved by themselves. This system is totally changed. The charter of 1769 exists no longer. It is reorganized, and reorganized in such a manner as to convert a literary institution, moulded according to the will of its founders, and placed under the control of private literary men, into a machine entirely subservient to the will of government. This may be for the advantage of this college in particular, and may be for the advantage of literature in general, but it is not according to the will of the donors, and is subversive of that contract on the faith of which their property was given.

In the view which has been taken of this interesting case, the court has confined itself to the rights possessed by the trustees, as the assignees and representatives of the donors and founders, for the benefit of religion and literature. Yet it is not clear that the trustees ought to be considered as destitute of such beneficial interest in themselves as the law may respect. In addition to their being the legal owners of the property, and to their having a freehold right in the powers confided to them, the charter itself countenances the idea that trustees may also be tutors with salaries. The first president was one of the original trustees, and the charter provides that in case of vacancy in that office "the senior professor or tutor, being one of the trustees, shall exercise the office of president until the trustees shall make choice of and appoint a president." According to the tenor of the charter, then, the trustees might, without impropriety, appoint a president and other professors from their own body. This is a power not entirely unconnected with an interest. Even if the proposition of the counsel for the defendant were sustained; if it were admitted that those contracts only are protected by the constitution, a beneficial interest in which is vested in the party who appears in court to assert that interest; yet it is by no means clear that the trustees of Dartmouth college have no beneficial interest in themselves.

But the court has deemed it unnecessary to investigate this particular point, being of opinion, on general principles, that in these private eleemosynary institutions the body corporate, as possessing the whole legal and equitable interest, and completely representing the donors, for the purpose of executing the trust, has rights which are protected by the constitution.

It results from this opinion that the acts of the legislature of New Hampshire, which are stated in the special verdict found in this cause, are repugnant to the constitution of the United States, and that the judgment on this special verdict ought to have been for the plaintiffs. The judgment of the state court must therefore be reversed.

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## STONE V. MISSISSIPPI.

SUPREME COURT OF THE UNITED STATES, 1879.

(101 U. S. 814.)

*Charter—Contract—License.*

Mr. Chief Justice Waite: It is now too late to contend that any contract which a State actually enters into when granting a charter to a private corporation, is not within the protection of the clause in the Constitution of the United States that prohibits States from passing laws impairing the obligation of contracts. Art. 1, sec. 10. The doctrine of the *Trustees of Dartmouth College v. Woodward*, 4 Wheat., 518, announced by this court more than sixty years ago, have become so imbedded in the jurisprudence of the United States as to make them, to all intents and purposes, a part of the Constitution itself. In this connection, however, it is to be kept in mind that it is not the charter which is protected, but only any contract the charter may contain. If there is no contract, there is nothing in the grant on which the Constitution can act. Consequently, the first inquiry in this class of cases always is, whether a contract has, in fact, been entered into, and if so, what its obligations are.

In the present case the question is, whether the State of Mississippi, in its sovereign capacity, did, by the charter now under consideration, bind itself irrevocably by a contract to permit "The Mississippi Agricultural, Educational and Manufacturing Aid Society," for twenty-five years, "to receive subscriptions, and sell and dispose of certificates of subscriptions which shall entitle the holders thereof to" "any lands, books, paintings, statues, antiques,

scientific instruments or apparatus, or any other property or thing that may be ornamental, valuable or useful," "awarded to them" "by the casting of lot, chance or otherwise." There can be no dispute but that, under this form of words, the Legislature of the State chartered a lottery company, having all the powers incident to such a corporation, for twenty-five years, and that, in consideration thereof, the company paid into the State treasury \$5,000 for the use of a university, and agreed to pay, and until the commencement of this suit did pay, an annual tax of \$1,000 and "One half of one per cent. on the amount of receipts derived from the sale of certificates or tickets." If the Legislature that granted this charter had the power to bind the people of the State and all succeeding Legislatures to allow the corporation to continue its corporate business during the whole term of its authorized existence, there is no doubt about the sufficiency of the language employed to effect that object, although there was an evident purpose to conceal the vice of the transaction by the phrases that were used. Whether the alleged contract exists therefore, or not, depends upon the authority of the Legislature to bind the State and the people of the State in that way.

All agree that the Legislature cannot bargain away the police power of a State. "Irrevocable grants of property and franchises may be made if they do not impair the supreme authority to make laws for the right government of the State; but no Legislature can curtail the power of its successors to make such laws as they may deem proper in matters of police." *Metropolitan Board of Excise v. Barrie*, 34 N. Y., 657; *Boyd v. Alabama*, 94 U. S., 645. Many attempts have been made in this court and elsewhere to define the police power, but never with entire success. It is always easier to determine whether a particular case comes within the general scope of the power, than to give an abstract definition of the power itself which will be in all respects accurate. No one denies, however, that it extends to all matters affecting the public health or the public morals. *Beer Co. v. Massachusetts*, 97 U. S., 25; *Patterson v. Kentucky*, 97 U. S., 501. Neither can it be denied that lotteries are proper subjects for the exercise of this power. We are aware that formerly, when the sources of public revenue were fewer than now, they were used in some or all of the States, and even in the District of Columbia, to raise money for the erection of public buildings, making public improvements, and not unfrequently for educational and religious purposes; but this court said, more than thirty years ago, speaking through Mr. Justice Grier, in *Phalen v. Virginia*, 8 How., 163, 168, that "Experience has shown that the common forms of gambling are comparatively innocuous when placed in contrast with the wide-spread pestilence of lot-

teries. The former are confined to a few persons and places, but the latter infests the whole community; it enters every dwelling; it reaches every class; it preys upon the hard earnings of the poor; and it plunders the ignorant and simple." Happily, under the influence of restrictive legislation, the evils are not so apparent now; but we very much fear that, with the same opportunities of indulgence, the same results would be manifested.

If lotteries are to be tolerated at all, it is, no doubt, better that they should be regulated by law, so that the people may be protected as far as possible against the inherent vices of the system; but that they are demoralizing in their effects, no matter how carefully regulated, cannot admit of a doubt. When the government is untrammelled by any claim of vested rights or chartered privileges, no one has ever supposed that lotteries could not lawfully be suppressed, and those who manage them punished severely as violators of the rules of social morality. From 1822 to 1867, without any constitutional requirement, they were prohibited by law in Mississippi, and those who conducted them punished as a kind of gamblers. During the Provisional Government of that State, in 1867, at the close of the late civil war, the present Act of incorporation, with more of like character, was passed. The next year, 1868, the people, in adopting a new Constitution with a view to the resumption of their political rights as one of the United States, provided that "The Legislature shall never authorize any lottery, nor shall the sale of lottery tickets be allowed, nor shall any lottery heretofore authorized be permitted to be drawn, or tickets therein to be sold." Art. 12, sec. 15. There is now scarcely a State in the Union where lotteries are tolerated, and Congress has enacted a special statute, the object of which is to close the mails against them. Rev. St., sec. 3894; 19 Stat. at L., 90, sec. 2.

The question is, therefore, directly presented, whether, in view of these facts, the Legislature of a State can, by the charter of a lottery company, defeat the will of the people, authoritatively expressed, in relation to the further continuance of such business in their midst. We think it cannot. No Legislature can bargain away the public health or the public morals. The people themselves cannot do it, much less their servants. The supervision of both these subjects of governmental power is continuing in its nature, and they are to be dealt with as the special exigencies of the moment may require. Government is organized with a view to their preservation, and cannot divest itself of the power to provide for them. For this purpose, the largest legislative discretion is allowed, and the discretion cannot be parted with any more than the power itself. *Beer Co. v. Massachusetts, supra.*

*In Trustees of Dartmouth College v. Woodward, 4 Wheat, 518,*



it was argued that the contract clause of the Constitution, if given the effect contended for in respect to corporate franchises, "would be an unprofitable and vexatious interference with the internal concerns of a state, would, unnecessarily and unwisely, embarrass its legislation, and render immutable those civil institutions which are established for the purpose of internal government, and which to subserve those purposes, ought to vary with varying circumstances" (p. 628); but *Mr. Chief Justice Marshall*, when he announced the opinion of the court, was careful to say (p. 629), "that the framers of the Constitution did not intend to restrain States in the regulation of their civil institutions, adopted for internal government, and that the instrument they have given us is not to be so construed." The present case, we think, comes within this limitation. We have held, not, however, without strong opposition at times, that this clause protected a corporation in its charter exemptions from taxation. While taxation is, in general, necessary for the support of government, it is not part of the government itself. Government was not organized for the purposes of taxation, but taxation may be necessary for the purposes of government. As such, taxation becomes an incident to the exercise of the legitimate functions of government, but nothing more. No government, dependent on taxation for support, can bargain away its whole power of taxation, for that would be substantially abdication. All that has been determined thus far is, that for a consideration it may, in the exercise of a reasonable discretion, and for the public good, surrender a part of its powers in this particular.

But the power of governing is a trust committed by the people to the government, no part of which can be granted away. The people, in their sovereign capacity, have established their agencies for the preservation of the public health and the public morals, and the protection of public and private rights. These several agencies can govern according to their discretion, if within the scope of their general authority, while in power; but they cannot give away nor sell the discretion of those that are to come after them, in respect to matters the government of which, from the very nature of things, must "vary with varying circumstances." They may create corporations, and give them, so to speak, a limited citizenship; but as citizens, limited in their privileges, or otherwise, these creatures of the government creation are subject to such rules and regulations as may from time to time be ordained and established for the preservation of health and morality.

The contracts which the Constitution protects are those that relate to property rights, not governmental. It is not always easy to tell on which side of the line which separates governmental from property rights a particular case is to be put; but in

respect to lotteries there can be no difficulty. They are not, in the legal acceptance of the term, *mala in se*, but as we have just seen, may properly be made *mala prohibita*. They are a species of gambling, and wrong in their influences. They disturb the checks and balances of a well ordered community. Society built on such a foundation would almost of necessity bring forth a population of speculators and gamblers, living on the expectation of what, "by the casting of lots, or by lot, chance or otherwise," might be "awarded" to them from the accumulations of others. Certainly the right to suppress them is governmental, to be exercised at all times by those in power, at their discretion. Anyone, therefore, who accepts a lottery charter, does so with the implied understanding that the people, in their sovereign capacity and through their properly constituted agencies, may resume it at any time when the public good shall require, whether it be paid for or not. All that one can get by such a charter is a suspension of certain governmental rights in his favor, subject to withdrawal at will. He has, in legal effect, nothing more than a license to enjoy the privilege on the terms named for the specified time, unless it be sooner abrogated by the sovereign power of the State. It is a permit, good as against existing laws, but subject to future legislative and constitutional control or withdrawal.

On the whole, we find no error in the record, and the judgment is affirmed.

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## BEER COMPANY V. MASSACHUSETTS.

SUPREME COURT OF THE UNITED STATES, 1877.

(97 U. S. 25.)

### *The Charter—Legislation Impairing the Obligation of a Contract.*

This was a proceeding in the Superior Court of Suffolk County, Massachusetts, for the forfeiture of certain malt liquors belonging to the Boston Beer Company, and which had been seized as it was transporting them to its place of business in said county, with intent there to sell them in violation of an act of the Legislature of Massachusetts, passed June 19, 1869, c. 415, commonly known as the Prohibitory Liquor Law. The company claimed that, under its charter, granted in 1828, it had the right to man-

ufacture and sell said liquors, and that said law impaired the obligation of the contract contained in that charter, and was void, so far as the liquors in question were concerned. The court refused to charge the jury to that effect, and a verdict was found against the claimant. The rulings of the Superior Court having been affirmed by the Supreme Judicial Court of the Commonwealth, the company brought the case here. The statutes of Massachusetts bearing on the case are referred to in the opinion of the court.

Mr. Justice Bradley delivered the opinion of the court:

The question raised in this case is whether the charter of the plaintiff, which was granted in 1828, contains any contract the obligation of which was impaired by the prohibitory liquor law of Massachusetts, passed in 1869, as applied to the liquor in question in this suit.

Some question is made by the defendant in error whether the point was properly raised in the state courts, so as to be the subject of decision by the highest court of the state. It is contended that, although it was raised by plea, in the municipal court, yet, that plea being demurred to, and the demurrer being sustained, the defence was abandoned, and the only issue on which the parties went to trial was the general denial of the truth of the complaint. But whatever may be the correct course of proceeding in the practice of courts of Massachusetts,—a matter which it is not our province to investigate,—it is apparent from the record that the very point now sought to be argued was made on the trial of the cause in the Superior Court, and was passed upon, and made decisive of the controversy, and was afterwards carried by bill of exceptions to the Supreme Judicial Court, and was decided there adverse to the plaintiff in error on the very ground on which it seeks a reversal.

The Supreme Court, in its rescript, expressly decides as follows:

"Exceptions overruled for the reasons following:

"The act of 1869, c. 415, does not impair the obligations of the contract contained in the charter of the claimant, so far as it relates to the sale of malt liquors, but is binding on the claimant to the same extent as on individuals.

"The act is in the nature of a police regulation in regard to the sale of a certain article of property, and is applicable to the sale of such property by individuals and corporations, even where the charter of the corporation cannot be altered or repealed by the Legislature."

The judgment of the Superior Criminal Court was entered in conformity to this rescript, declaring the liquors forfeited to the commonwealth, and that a warrant issue for the disposal of the same.

This is sufficient for our jurisdiction, and we are bound to consider the question which is thus raised.

As before stated, the charter of the plaintiff in error was granted in 1828, by an act of the Legislature passed on the 1st of February in that year, entitled "An Act to incorporate the Boston Beer Company." This act consisted of two sections. By the first it was enacted that certain persons (named), their successors and assigns, "be, and they hereby are, made a corporation, by the name of The Boston Beer Company, for the purpose of manufacturing malt liquors in all their varieties, in the city of Boston, and for that purpose shall have all the powers and privileges, and be subject to all the duties and requirements, contained in an act passed on the third day of March, A. D. 1809, entitled 'An Act defining the general powers and duties of manufacturing corporations,' and the several acts in addition thereto." The second section gave the company power to hold such real and personal property to certain amounts as might be found necessary and convenient for carrying on the manufacture of malt liquors in the city of Boston.

The general manufacturing act of 1809, referred to in the charter, had this clause as a proviso of the seventh section thereof: "Provided always, that the Legislature may from time to time, upon due notice to any corporation, make further provisions and regulations for the management of the business of the corporation and for the government thereof, or wholly to repeal any act or part thereof, establishing any corporation, as shall be deemed expedient."

A substitute for this act was passed in 1829, which repealed the act of 1809, and all acts in addition thereto, with this qualification: "But this repeal shall not affect the existing rights of any person, or the existing or future liabilities of any corporation or any members of any corporation now established, until such corporation shall have adopted this act and complied with the provisions herein contained."

It thus appears that the charter of the company, by adopting the provisions of the act of 1809, became subject to a reserved power of the Legislature to make further provisions and regulations for the management of the business of the corporation and for the government thereof, or wholly to repeal the act, or any part thereof, establishing the corporation. This reservation of the power was a part of the contract.

But it is contended by the company that the repeal of the act of 1809 by the act of 1829 was a revocation or surrender of this reserved power.

We cannot so regard it. The charter of the company adopted the provisions of the act of 1809 as a portion of itself, and those

provisions remained a part of the charter notwithstanding the subsequent repeal of the act. The act of 1829 reserved a similar power to amend or repeal that act at the pleasure of the Legislature, and declared that all corporations established under it should cease and expire at the same time when the act should be repealed. It can hardly be supposed that the Legislature, when it reserved such plenary powers over the corporations to be organized under the new act, intended to relinquish all its powers over the corporations organized under or subject to the provisions of the former act. The qualification of the repeal of the act of 1809, before referred to, seems to be intended not only to continue the existence of the corporations subject to it in the enjoyment of all their privileges, but subject to all their liabilities, of which the reserved legislative control was one.

If this view is correct, the Legislature of Massachusetts had reserved complete power to pass any law it saw fit, which might affect the powers of the plaintiff in error.

But there is another question in the case, which, as it seems to us, is equally decisive.

The plaintiff in error was incorporated "for the purpose of manufacturing malt liquors in all their varieties," it is true, and the right to manufacture, undoubtedly, as the plaintiff's counsel contends, included the incidental right to dispose of the liquors manufactured. But although this right or capacity was thus granted in the most unqualified form, it cannot be construed as conferring any greater or more sacred right than any citizen had to manufacture malt liquor, nor as exempting the corporation from any control therein to which a citizen would be subject, if the interests of the community should require it. If the public safety or the public morals require the discontinuance of any manufacture or traffic, the hand of the Legislature cannot be stayed from providing for its discontinuance by any incidental inconvenience which individuals or corporations may suffer. All rights are held subject to the police power of the state.

We do not mean to say that property actually in existence, and in which the right of the owner has become vested, may be taken for the public good without due compensation. But we infer that the liquor in this case, as in the case of *Bartmeyer v. Iowa*, 18 Wall. 129, was not in existence when the liquor law of Massachusetts was passed. Had the plaintiff in error relied on the existence of the property prior to the law, it behoved it to show that fact. But no such fact is shown, and no such point is taken. The plaintiff in error boldly takes the ground that, being a corporation, it has a right, by contract, to manufacture and sell beer forever, notwithstanding and in spite of any exigencies which may occur in the morals or the health of the community, requiring

such manufacture to cease. We do not so understand the rights of the plaintiff. The Legislature had no power to confer any such rights.

Whatever differences of opinion may exist as to the extent and boundaries of the police power, and however difficult it may be to render a satisfactory definition of it, there seems to be no doubt that it does extend to the protection of the lives, health and property of the citizens, and to the preservation of good order and the public morals. The Legislature cannot, by any contract, divest itself of the power to provide for these objects. They belong emphatically to that class of objects which demand the application of the maxim *salus populi suprema lex*, and they are to be attained and provided for by such appropriate means as the legislative discretion may devise. That discretion can no more be bargained away than the power itself. *Boyd v. Alabama*, 94 U. S. 645.

Since we have already held, in the case of *Bartemeyer v. Iowa*, that as a measure of police regulation, looking to the preservation of public morals, a state law prohibiting the manufacture and sale of intoxicating liquors is not repugnant to any clause of the constitution of the United States, we see nothing in the present case that can afford any sufficient ground for disturbing the decision of the Supreme Court of Massachusetts.

Of course, we do not mean to lay down any rule at variance with what this court has decided with regard to the paramount authority of the constitution and laws of the United States, relating to the regulation of commerce with foreign nations and among the several states, or otherwise. *Brown v. Maryland*, 12 Wheat. 419; *License Cases*, 5 How. 504; *Passenger Cases*, 7 id. 283; *Henderson v. Mayor of New York*, 92 U. S. 259; *Chy Lung v. Freeman*, id. 275; *Railroad Company v. Husen*, 95 id. 465. That question does not arise in this case.

*Judgment affirmed.*

## CHAPTER V.

## POWERS.

## DOWNING V. MOUNT WASHINGTON ROAD COMPANY.

SUPREME COURT OF NEWHAMPSHIRE, 1860.

(40 N. H. 330)

*Powers of Corporation—Construction of Charter.*

Assumpsit to recover the price of certain vehicles made under a contract with the president of the defendant corporation. Defendant denied the authority of the president to make such a contract.

Bell, C. J.: Corporations are creatures of the legislature, having no other powers than such as are given to them by their charters, or such as are incidental, or necessary to carry into effect the purposes for which they were established. *Trustees v. Peaslee*, 15 N. H. 330; *Perrine v. Chesapeake Canal Co.*, 9 How. 172. In giving a construction to the powers of a corporation, the language of the charter should in general neither be construed strictly nor liberally, but according to the fair and natural import of it, with reference to the purposes and objects of the corporation. *Enfield Bridge v. Hartford R. R.*, 17 Conn. 454; *Strauss Eagle Co.*, 5 Ohio (N. S.) 39.

If the powers conferred are against common right, and trench in any way upon the privileges of other citizens, they are, in cases of doubt, to be construed strictly, but not so as to impair or defeat the objects of the incorporation.

In the present case the power to take the lands of others, and to take tolls of travellers, must be strictly construed, if doubts should arise on those points; but it is not seen that the other grants to the defendant corporation should not receive a fair and natural construction.

The charter of the Mount Washington road empowers them to lay out, make and keep in repair, a road from Peabody River Valley to the top of Mount Washington, and thence to some point on the northwest side of the mountain. It grants tolls on passengers and carriages, and authorizes them to take lands of others for their road, and to build and own toll-houses, and erect gates, and appoint toll-gatherers to collect their tolls. The remaining

provisions contain the ordinary powers of corporations relating to directors, stock, dividends, meetings, etc. Laws of 1853, chapter 1486.

This chapter confers the usual powers heretofore granted to turn-pike corporations, and no others. The most natural and satisfactory mode of ascertaining what are the powers incidentally granted to such companies, is to inquire what powers have been usually exercised under them, without question by the public or by the corporators. It may be safely assumed that the powers which have not heretofore been found necessary, and have not been claimed or exercised under such charters, are not to be considered generally as incidentally granted. Such charters have in former years been very common in this and other states, and they have not, so far as we are aware, been understood as authorizing the corporations to erect hotels, or to establish stage or transportation lines, to purchase horses or carriages, or to employ drivers in transporting passengers or freight over their roads; and no such powers have anywhere been claimed or exercised under them. We are, therefore, of opinion that the power to establish stage and transportation lines to and from the mountain, to purchase carriages and horses for the purpose of carrying on such a business, was not incidentally granted to the defendant corporation by their charter. *State v. Commissioners*, 3 Zab. 510.

But it is contended that the power to make this contract is conferred by the act in amendment of the charter, passed July 12, 1856. By this act the corporation may "erect and maintain, lease and dispose of any building or buildings which may be found convenient for the accommodation of their business, and of the horses and carriages and travellers passing over their said road." By their business, which the buildings to be erected were designed to accommodate, it is said the legislature must have intended some permanent and continuing business beyond that of merely building and maintaining a road; and that it could be no other than that of erecting a hotel on the mountain, and establishing lines of carriages, for the purpose of carrying visitors up and down the mountain.

But the foundation of this implication is very slight. The express grant is of an authority to erect, etc., buildings, not of all kinds, but such as may be found convenient for the accommodation of their business, and of travellers, etc. The business here referred to must be understood to be such as they are by their charter authorized to engage in. If nothing had been said of horses and travellers, there could hardly be any foundation for the idea that a hotel could have been contemplated by the legislature. Buildings suitable for the accommodation of their toll-



gatherers and workmen employed on their road, would probably be thought everything the legislature intended to authorize by this additional act. Connected as this authority now is with travellers, horses, and carriages, there is scarce a pretence for argument that this additional act goes any further than the original act, to authorize a stage and transportation company. It is not unlikely that some of the projectors of this enterprise intended to secure much more extensive rights than those of a turnpike and hotel company, but it seems certain they have not exhibited this feature of their case to the legislature so distinctly as to secure their sanction, and the charter and its amendment as yet justifies them in no such claim.

The power of buying and selling real and personal property for the legitimate purposes of the corporation, and the power of contracting generally for the same purposes, within the limits prescribed by the charter, being granted, we understand the principle to be, that their purchases, sales, and contracts generally, will be presumed to be made within the legitimate scope and purpose of the corporation, until the contrary appears, and that the burden of showing that any contract of a corporation is beyond its legitimate powers, rests on the party who objects to it. *Indiana v. Worum*, 6 Hill, 37; *Ex parte Peru Iron Company*, 7 Cow. 540; *Farmer's Loan Clowes*, 3 Comst. 470; *Same v. Curtis*, 3 Seld. 466; *Biers v. Phenix Company*, 14 Barb. 358.

If a corporation attempt to enforce a contract made with them in a case beyond the legitimate limits of their corporate power, that fact, being shown, will ordinarily constitute a perfect defence. *Green v. Seymour*, 3 Sandf. Ch. 285; *Bangor Boom v. Whiting*, 29 Me. 123; *Life, &c., Company v. Manufacturers, &c. Company*, 7 Wend. 31; *New York &c. Insurance Company v. Ely*, 5 Conn. 560.

And if a suit is brought upon a contract alleged to be made by the corporation, but which is shown to be beyond its corporate power to enter into, the contract will be regarded as void, and the corporation may avail themselves of that defence. *Beach v. Fulton Bank*, 3 Wend. 573; *Albert v. Savings Bank*, 1 Md. Ch. Dec. 407; *Abbot v. Baltimore, &c. Company*, 1 Md. Ch. Dec. 542; *Strauss v. Eagle Insurance Company*, 5 Ohio, n. s. 59; *Baron v. Mississippi Insurance Company*, 31 Miss. 116; *Bank of Genesee v. Patchin Bank*, 3 Kern. 315; *Gage v. Newmarket* 18 Q. B. 457.

The contract set up in this case was made not by the corporation itself, by a vote, nor by an agent expressly authorized to sign a contract already drawn, but it was made by the president of the corporation, acting under an appointment as their general agent; and it is argued that he was fully authorized by votes of

the corporation to bind them by such a contract as the present; but it is not necessary to consider this question, as we think it settled that the powers of the agents of corporations to enter into contracts in their behalf are limited, by the nature of things, to such contracts as the corporations are by their charters authorized to make. This principle is distinctly recognized in *McCullough v. Moss*, 5 Den. 567; overruling the case of *Moss v. Rossie Lead Co.*, 5 Hill, 137, and in *Central Bank v. Empire Co.*, 26 Barb. 23; *Bank of Genesee v. Patchin Bank*, 3 Kern. 315.

This same want of power to give authority to an agent to contract, and thereby bind the corporation in matters beyond the scope of their corporate objects, must be equally conclusive against any attempt to ratify such contract. What they cannot do directly they cannot do indirectly. They cannot bind themselves by the ratification of a contract which they had no authority to make. 5 Den. 567, above cited. The power of the agent must be restricted to the business which the company was authorized to do. Within the scope of the business which they had power to transact, he, as its agent, may be authorized to act for it, but beyond that he could not be authorized, for its powers extend no further.

This view seems to us entirely conclusive against the claim made for the omnibuses and model, and probably for the baggage wagon.

As to the light wagon, that may stand on a different ground. Such a wagon might be useful and necessary for the use of the agent of the company, in conducting the undoubted business of the corporation,—the building and maintaining the road.

We are unable to assent to the position taken in the argument, that a ratification of part is a ratification of the whole contract. While the corporation may be restricted from ratifying a contract beyond the scope of the objects of the corporation, there could be no such objection as to any matter clearly within their power. The other contracting party might have a right to reject such ratification, claiming that the contract is entire, and if not ratified as such, it should not be made good for a part only. But if they claim the benefit of the partial ratification, the corporation can hardly object.

## NICOLL V. RAILROAD COMPANY.\*

SUPREME COURT OF NEW YORK, 1854.

(12 N. Y. 121.)

*Power to Acquire and Convey Real Estate.*

Ejectment commenced in the supreme court in February, 1847, and tried at the Orange county circuit, held by Mr. Justice Edwards in October, 1848. The jury found a special verdict, from which it appeared that on the first day of July, 1836. Nicholas A. Dederer, being the owner in fee simple of a farm situate in Blooming Grove, Orange county, executed to the Hudson and Delaware Railroad Company a deed, dated that day, whereby, in consideration of the benefits and advantages to him of the railroad proposed to be made by the company, and of one dollar to him paid by the company, he granted to such company the privilege of surveying and laying out by its agents and engineers, through his farm or tract of land, the route and site of its road; and also granted, bargained, sold, and conveyed unto the company and its successors, so much of the farm as might be selected and laid out by the company for the site of its railroad, six rods in width across the farm, provided always, and such grant was made upon the express condition that the company should construct its railroad within the time prescribed by the act incorporating the same. That subsequently and before the 27th of October, 1836, the company selected and laid out, for the site of its railroad through the farm, a strip of land six rods wide extending through the farm. That on the 1st of April, 1844, the farm formerly owned by Dederer, by virtue of sundry mesne conveyances became the property of the plaintiff in fee simple subject only to such right as the Hudson and Delaware Railroad Company then had to any portion thereof, sufficient for the track of its road. That this company, on the 27th of Oct-

\*Page v. Heineberg, 40 Vt. 81. (1868.); White v. Howard, 38 Conn. 342. (1871.); Leasure v. Hillegas, 7 Serg & R. 813. (1821.); Hough v. Land Co., 73 Ill. 28. (1874.); National Bank v. Matthews, 98 U. S. 621. (1878.); National Bank v. Whitney, 103 U. S. 99. (1880.); Case v. Kelly, 123 U. S. 21. (1890.); People v. La Rue, 67 Cal 526. (1888).

ober, 1836, commenced the construction of its railroad, but never completed or put in operation a double or single track or any part thereof. That in pursuance of an act of the Legislature, entitled an act authorizing the New York and Erie Railroad Company to construct a branch road, terminating at the village of Newburgh, passed April 8, 1845, the Hudson and Delaware Railroad Company were authorized to, and on the 14th of December, 1846, did execute to the defendant, the New York and Erie Railroad Company, a deed, and thereby for a valuable consideration granted, bargained, sold, and conveyed to the defendant and its successors, the maps, charts, drafts, surveys, and other personal property of the Hudson and Delaware Company, and all its rights, privileges, immunities and improvements, acquired under and by virtue of the original act of incorporation or of any act amending it, or in any other manner; and also all the grants, lands, and real estate acquired by or ceded or conveyed to the Hudson and Delaware Company, and all its right, title, and interest to the same, and particularly the right of way, granted by Dederer to the Company and its successors, by the deed from him above mentioned. That when this suit was commenced on the 25th of February, 1847, the defendant had not completed or put in operation its branch road terminating at Newburgh, or any part of it, nor had it done so when the cause was tried. That on the 2nd of December, 1846, the defendant entered upon the strip of land six rods wide, mentioned in the deed from Dederer and laid out by the Hudson and Delaware Company through his farm, as the site of its road, and ejected the plaintiff therefrom, and that the defendant was still in the possession thereof. The suit was brought to recover possession of this strip of land from the defendant.

The justice before whom this cause was tried ordered judgment upon the special verdict in favor of the plaintiff. The defendant appealed, and the Supreme Court, sitting in general term in the 3d district, reversed the judgment, and gave judgment in favor of the defendant. (12 Barb. 460.) The plaintiff appealed to this court.

Parker, J.:—The grant from Dederer to the Hudson and Delaware Railroad Company, bearing date the first day of July, 1836, was made to that company "and their successors." Under that grant, there can be no doubt, the Hudson and Delaware Railroad Company took a fee. The words of perpetuity used would have been sufficient to describe a fee, even under the most strict requirements of the common law.

The company had ample power to purchase lands. It was a power incident at common law to all corporations unless they were specially restrained by their charters or by statute. 2 Kent,

281; Co. Litt. 44 a. 300 b.; 1 Kyd. on Corp., 76, 78, 108, 115; 3 Pick. 239. And in this case the power was expressly conferred by the 9th section of the charter (Sess. Laws of 1835, p. 113); and by the 16th section there were given to it the general powers conferred upon corporations (1 R. S. 731), one of which is that of holding, purchasing, and conveying such real estate as the purposes of the corporation may require. But if no words of perpetuity had been used, the grantor owning a fee, the company would have taken a fee, for the statute is now imperative that every grant shall pass all the estate or interest of the grantor, unless the intent to pass a less estate or interest shall appear by express terms or be necessarily implied in the terms of the grant (1 R. S. 748, § 1).

But it is objected that because by the act of incorporation there was given to it only a term of existence of fifty years (Laws of 1835, p. 110, § 1), therefore the grant shall be deemed to have conveyed an estate for years, and not in fee. The unsoundness of that position is easily shown. It was never yet held that the grant of a fee in express terms could be restricted by the fact that the grantee had but a limited term of existence. If it were so, a grant could never be made to an individual in fee, because in his earthly existence he is not immortal. Under such a rule a man could never buy a greater interest in a farm than a life estate. It would follow that all estates would be life estates except those held by perpetual corporations. The intent of parties, fully expressed in a deed, would avail nothing, but all grants would be measured by the mortality of the grantee. It is needless to follow out the proposition further to show its absurdity.

It is not to the parties to a grant, but to its terms, that we look to ascertain the character and extent of the estate conveyed. Such was the rule at common law, and is still by statute. (1 R. S. 748, § 1). The change made by the statute favors the grantee where there are no express terms in the grant, by presuming the grantor intended to convey all his estate.

At common law it was only where there were no express terms defining the estate in the conveyance, that the term of legal existence of the grantee was deemed to be the measure of the interest intended to be conveyed. Thus, words of perpetuity, such as "heirs or successors," were necessary to convey a fee. A grant to an individual without such words conveyed only a life estate. For the same reason a grant without such words to a corporation aggregate (Viner's Ab., Estate, L. 3), or to a mayor or commonalty (ib. 3), conveyed a fee, because the grantees were perpetual. The grantee named in such case having a perpetual existence, the estate could not have been enlarged by words of succession.

But this is now changed by our Revised Statutes. Words of inheritance or succession are no longer necessary, and in their absence we look not to the terms of existence of the grantee to ascertain the estate, but to the amount of interest owned by the grantor at the time he conveyed. All this estate is deemed to have passed by the grant. (1 R. S. 748, § 1).

All this is applicable only to cases where the grant is silent as to the extent of interest conveyed. Where that interest is expressly described, as in this case, the law never, either before or since our revision, did violence to the intent of the parties, by cutting down the estate agreed to be conveyed to the measure of the grantee's term of existence. It has long been one of the maxims of the law that "no implication shall be allowed against an express estate limited by express words." Viner's *Ab. Implication*, A. 5; 1 Salk. 236.

It is erroneous to say that an estate in fee cannot be fully enjoyed by a natural person, or by a corporation of limited duration. It is an enjoyment of the fee to possess it and to have the full control of it, including the power of alienation, by which its full value may at once be realized.

It is well settled that corporations, though limited in their duration, may purchase and hold a fee, and they may sell such real estate whenever they shall find it no longer necessary or convenient (5 Denio, 389). 2 Preston on Estates, 50. Kent says: "Corporations have a fee simple for the purpose of alienation, but they have only a determinable fee for the purpose of enjoyment. On the dissolution of the corporation the reverter is to the original grantor or his heirs; but the grantor will be excluded by the alienation in fee, and in that way the corporation may defeat the possibility of a reverter." 2 Kent, 282; 5 Denio, 389; 1 Comst. R. 509. Large sums of money are accordingly expended by railroad companies in erecting extensive station houses and depots, and by banking corporations in erecting banking houses, because, holding the land in fee, they may be able to reimburse themselves for the outlay by selling the fee before the termination of their corporate existence. \* \* \*

Upon the whole my conclusion in this case is that the Hudson and Delaware Railroad Company took from Dederer a fee upon condition subsequent; that at the time of the conveyance by Dederer to the plaintiff, there had been no forfeiture; and that Dederer had, at the time of such conveyance, no assignable interest in the premises.

The judgment of the Supreme Court should be affirmed.

## MONUMENT NATIONAL BANK V. GLOBE WORKS.\*

SUPREME JUDICIAL COURT OF MASSACHUSETTS, 1869.

(101 Mass. 57.)

*Power to make Negotiable Paper—Accommodation Endorser.*

Hoar J.: The single question presented for our decision in this cause, all others which arise upon the report having been waived, is, whether the note of a manufacturing corporation, in the hands of a holder in good faith for value, who took it before maturity, and without any knowledge that the makers had not received the full consideration, cannot be enforced against them, because it was in fact made as an accommodation note.

The argument for the defendants takes the ground that to issue an accommodation note is not within the powers conferred upon the corporation; and that, as any persons taking it had notice that it was the note of the corporation, they had notice that it was of no validity unless issued for a purpose within the scope of the corporate powers, and were therefore bound to ascertain not only that it was executed by the officer of the corporation who had the general authority to sign the notes which they might lawfully make, but that the purpose for which it was issued was such as the charter authorized them to entertain and execute.

The court are all of opinion that this position is not tenable, and that the defence cannot be maintained.

It has long been settled in this Commonwealth that a manufacturing corporation has the power to make a negotiable promissory note. *Narragansett Bank v. Atlantic Silk Co.*, 3 Met. 282. And it was held in *Bird v. Daggett*, 97 Mass. 494, as a just corollary to that proposition, that such a note in the hands of a holder in good faith for value is binding upon the maker, although made as an accommodation note. The question was not discussed, nor the reasons for the decision fully stated, in *Bird v. Daggett*; but it was assumed that the doctrine announced was clear and undoubted law.

The doctrine of *ultra vires* has been carried much farther in England than the courts in this country have been disposed to extend it; but, with just limitations, the principle cannot be

\**Union Bank v. Jacobs*, 6 Humph. (Tenn.) 515. (1845); *National Park Bank v. German American Co.*, 116 N. Y. 281. (1889.) Power to accept bill of exchange, *Bateman v. Rail way Co.*, L. R. 1 C. P. 499. (1866.)

questioned, that the limitations to the authority, powers, and liability of a corporation are to be found in the act creating it. And it no doubt follows as claimed by the learned counsel for the defendants, that when powers are conferred and defined by statute, everyone dealing with the corporation is presumed to know the extent of those powers.

But when the transaction is not the exercise of a power not conferred on a corporation but the abuse of a general power in a particular instance, the abuse not being known to the other contracting party, the doctrine of *ultra vires* does not apply. As was said by Selden J., in *Bissell v. Michigan Southern & Northern Indiana Railroad Co.*, 22 N. Y. 289, 290: "There are no doubt cases in which a corporation would be estopped from setting up this defense, although its contract might have been really unauthorized. It would not be available in a suit brought by a *bona fide* indorsee of a negotiable promissory note, provided the corporation was authorized to give notes for any purpose; and the reason is, that the corporation, by giving the note has virtually represented, that it was given for some legitimate purpose. and the indorsee could not be presumed to know the contrary, The note, however, if given by a corporation absolutely prohibited by its charter from giving notes at all, would be voidable not only in the hands of the original payee, but in those of any subsequent holder; because all persons dealing with a corporation are bound to take notice of the extent of its chartered powers. The same principle is applicable to contracts not negotiable. When the want of power is apparent upon comparing the act done with the terms of the charter, the party dealing with the corporation is presumed to have knowledge of the defect, and the defence of *ultra vires* is available against him. But such a defence would not be permitted to prevail against a party who cannot be presumed to have had any knowledge of the want of authority to make the contract. Hence, if the question of power depends not merely upon the law under which the corporation acts, but upon the existence of certain extrinsic facts, resting peculiarly within the knowledge of the corporate officers, then the corporation would be estopped from denying that which, by assuming to make the contract it had virtually affirmed."

This doctrine seems to us sound and reasonable; and in conformity with it it was held in *Farmers' & Mechanics' Bank v. Empire State Stone Dressing Co.*, 5 Bosw. 275, that an accommodation acceptance by an officer of a manufacturing corporation, on behalf of the company, was not binding, unless the consideration had been advanced upon the faith of acceptance; but that if the consideration was paid in good faith after the acceptance, and upon the credit of it, it could be enforced.



So it was said by Lord St. Leonards that he felt a disposition "to restrain the doctrine of *ultra vires* to clear cases of excess of power, with the knowledge of the other party, express or implied from the nature of the corporation, and of the contract entered into." *Eastern Counties Railway Co. v. Hawkes*, 5 H.L. Cas. 331, 373.

The cases on which the defendants rely are cases against municipal corporations, in respect to which the rule is much more rigid, or for the most part those in which the other contracting party had notice upon the face of the transaction of the want of corporate power.

There can be no doubt that it is very often true that a corporation may be responsible for the unauthorized, and even for the unlawful acts of its agents, apparently clothed with its authority. No corporation is empowered by its charter to commit an assault and battery; yet it has frequently been held accountable, in this Commonwealth, for one committed by its servants.

Bills of a bank issued without consideration, and even stolen, are good in the hands of an innocent holder for value. Many other illustrations might be given, but enough has been said to show the principle on which our decision rests.

Judgment for the plaintiffs.

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### JONES V. GUARANTEE COMPANY.\*

SUPREME COURT OF THE UNITED STATES, 1879.

(101 U. S. 622.)

#### *Power to give a Mortgage.*

Mr. Justice Swayne: \* \* \* The central and controlling questions to be determined are:—

Whether the Oil Company had the power to give a mortgage for future advances; and,

Whether the mortgage here in question is, in the view of a court of equity, for the debt of the Oil Company or for the debt of Abraham M. Cozzens.

The oral arguments of the eminent counsel who appeared before us were addressed principally to these subjects. Numerous other points are made by the counsel for the appellant in his brief, and

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\**Comm. v. Smith*, 10 Allen 448, (1865).

have been fully discussed in the printed arguments upon both sides. They are minor in their character, and we think involve no proposition that admits of doubt as to its proper solution. We are satisfied with the disposition made of them by the Circuit Court, and shall pass them by without further remark.

At the common law, every corporation had, as incident to its existence, the power to acquire, hold, and convey real estate, except so far as it was restrained by its charter or by act of Parliament. This comprehensive capacity included also personal effects of every kind.

The *jus disponendi* was without limit or qualification. It extended to mortgages given to secure the payment of debts. 1 Kyd, Corp. 69, 76, 78, 108; Angell & Ames, § 145; 2 Kent, Com. 282; *Reynolds v. Commissioners of Stark County*, 5 Ohio, 204, *Whitewater Valley Canal Co. v. Valette*, 21 How. 414.

A mortgage for future advances was recognized as valid by the common law. *Gardner v. Graham*, 7 Vin. Abr. 22, pl. 3. See also *Brinkerhoff v. Marvin*, 5 Johns. (N. Y.) Ch. 320, *Lawrence v. Tucker*, 23 How. 14.

It is believed that they are held valid throughout the United States, except where forbidden by the local law.

The statute under which the Oil Company came into existence made it "capable in law of purchasing, holding, and conveying any real and personal estate, whenever necessary to enable" it to carry on its business; but it was forbidden to "mortgage the same, or give any lien thereon." This disability was removed by the later act of 1864, which expressly conferred the power before withheld. This change was remedial, and the clause which gave it is, therefore, to be construed liberally with reference to the ends in view.

The learned counsel for the appellant insisted that a mortgage could be competently given by the Oil Company only to secure a debt incurred in its business and already subsisting. This, we think is too narrow a construction of the language of the law. A thing maybe within a statute but not within its letter, or within the letter and yet not within the statute. The intent of the lawmaker is the law. *The People v. Utica Insurance Co.*, 16 Johns. (N. Y.) 357; *United States v. Babbit*, 1 Black, 55.

The view of the court in *Thompson v. New York & Hudson River Railroad Co.*, 3 Sandf. (N. Y.) Ch. 625 was sounder and better law. There the charter authorized the corporation to build a bridge. It found one already built that answered every purpose, and bought it. The purchase was held to be *intra vires* and valid. Here the object of the authorization is to enable the company to procure the means to carry on its business. Why should it be required to go into debt, and then borrow, if it could,

instead of borrowing in advance, and shaping its affairs accordingly? No sensible reason to the contrary can be given. If it may borrow and give a mortgage for a debt antecedently or contemporaneously created, why may it not thus provide for future advances as it may need them? This may be more economical and more beneficial than any other arrangement involving the security authorized to be given. In both these later cases the ultimate result with respect to the security would be just the same as if the mortgage were given for a pre-existing debt in literal compliance with the statute. No one could be wronged or injured, while the corporation, whom it was the purpose of the law to aid, might be materially benefited. Is not such a departure within the meaning, if not the letter, of the statute? There would be no more danger of the abuse of the power conferred than if it were exercised in the manner insisted upon. The safeguard provided in the required assent of stockholders would apply with the same efficacy in all the cases. The object of the loan, the application of the money, and the restraints imposed by the charter in those particulars, would be the same whether the transaction took one form or the other. According to our construction the company could give no mortgage but one growing out of their business, and intended to aid them in carrying it on. In legal effect the difference between the two constructions is one merely of mode and manner, and not of substance.

Such securities are not contrary to the law or public policy of the State. Many cases are found in her reported adjudications where both judgments and mortgages for future advances have been sustained.

Our view is not without support from the language of the statute, that "every mortgage so made shall be as valid to all intents and purposes as if executed by an individual owning such real estate." If this mortgage had been given by individuals, the question we are examining doubtless would not have been brought before us for consideration.

When a deed is fatally defective for the want of a sufficient consideration to support it such consideration subsequently arising may cure the defect and give the instrument validity. *Sumner v. Hicks*, 2 Black, 532. It is not necessary to go through the form of executing a second deed to take the place of the first one. This principle applies to the mortgage after all the advances had been made, conceding that it had before been invalid for the reason insisted upon.

The statute of 1864 neither expressly forbids nor declares void mortgages for future advances.

If the one here in question be *ultra vires*, no one can take advantage of the defect of power involved but the State. As to all other parties it must be held valid, and may be enforced accordingly. *Silver Lake Bank v. North*, 4 Johns. (N. Y.) Ch. 370; *National Bank v. Mathews*, 98 U.S. 621. In the latter case this subject was fully examined.

A corporation can act only by its agents. If there were any such technical defect as is claimed touching the execution of this mortgage, it has been cured by acquiescence and ratification by the mortgagor.

No one else can raise the question. All other parties are concluded. *Gordon v. Preston*, 1 Watts (Pa.) 385.

Where money had been obtained by a corporation upon its securities, which were irregular and *ultra vires*, but the money was applied for the benefit of the company, with the knowledge and acquiescence of the shareholders, the company and the shareholders were estopped from denying the liability of the company to repay it. And the same results follows where such securities are issued with the knowledge of the shareholders, so far as the money thus raised is applied for the benefit of the company. In *re Cork & Youghal Railway Co.*, Law Rep. 4 Ch. 748.

A court of equity abhors forfeitures, and will not lend its aid to enforce them. *Marshall v. Vicksburg*, 15 Wall. 146. Nor will it give its aid in the assertion of a mere legal right contrary to the clear equity and justice of the case. *Lewis v. Lyons*, 13 Ill. 117.

The second point to be considered is whether the mortgage was for the debt of Cozzens or for the debt of the Oil Company. \* \* \*

We are satisfied beyond a doubt that it was the debt of the Oil Company and not his debt that was intended to be secured and was secured by the mortgage. \* \* \*

Decree affirmed.

## FRANKLIN BANK V. COMMERCIAL BANK.\*

SUPREME COURT OF OHIO, 1881.

(26 Ohio St. 250.)

*Power of One Corporation to Hold Stock in Another Corporation.*

Boynton J.: We are met at the threshold of the case with the inquiry, whether an action will lie in favor of the plaintiff against the defendant for refusing to transfer, on the books of the defendant, to the name of the plaintiff, the two hundred shares of the capital stock of the defendant, represented by the certificate issued to Foote, and by him pledged to the plaintiff as security for the loan obtained. Such refusal to so transfer said stock, and an alleged consequent conversion of the same by the defendant constitute the gravamen of the plaintiff's action. The 12th section of the act under which the two corporations were organized and from which they derived their powers, expressly provided, that no banking company organized under its provisions should be the holder or purchaser of any portion of its capital stock or of the capital stock of any other incorporated company, unless such purchase should be necessary to prevent loss upon a debt previously contracted in good faith, on security which, at the time, was deemed adequate to insure the payment of such debt, independent of any lien upon such stock (1 S. & C. 170, §12). And by section 29 it was provided, that all the rights, privileges, and franchises which the company derived from the act should be forfeited, if the directors of the company should knowingly violate, or permit any of the officers or agents of the company to violate any of the provisions of the act. That the stock in the present case was pledged or received to secure a precedent loan is not claimed.

There would seem to be little doubt, either upon principle or authority, and independently of express statutory prohibition of the same, that one corporation cannot become the owner of any portion of the capital stock of another corporation, unless authority to become such is clearly conferred by statute, *Mutual Savings Bank, &c. v. Meriden Agency*, 24 Conn. 159; *Franklin Company v. Lewiston Savings Bank*, 68 Me. 43; *Central Railroad*

\**Milbank v. Railroad Co.*, 64 How. Pr. (N. Y.) 20, (1882). In re *Asiatic Banking Co. L. R.* 4 Ch. App. 252, (1869). *First National Bank v. National Exchange Bank*, 92 U.S. 122, (1875)

*Company v. Collins*, 40 Ga. 582; *Sumner v. Marcy*, 3 W. & M. 105. Were this not so, one corporation, by buying up the majority of the shares of the stock of another, could take the entire management of its business, however foreign such business might be to that which the corporation so purchasing said shares was created to carry on. A banking corporation could become the operator of a railroad, or carry on the business of manufacturing and any other corporation could engage in banking by obtaining the control of the bank's stock. Nor would this result follow any the less certainly, if the shares of stock were received in pledge only, to secure the payment of a debt, provided the shares were transferred on the books of the company to the name of the pledgee. A person in whose name the stock of a corporation stands on the books of the corporation is, as to the corporation, a stockholder, and has a right to vote upon the stock. *State ex rel. White v. Ferris*, 42 Conn. 560; *Ex parte Wilcox*, 7 Cow. 402; *In re Barker*, 6 Wend. 509. *Hopin v. Buffum*, 9 R. I. 513: *Field on Corp.* § 69.

Hence, if the plaintiff appeared on the books of the defendant as the transferee or owner of the two hundred shares of stock represented by the certificate to Foote, it would have the right to vote upon the stock at all meetings of the stockholders or the defendant; and it would only be necessary for it to procure in pledge, as security as money loaned, a majority of the shares of the capital stock of the Commercial Bank, in order to obtain full control of its affairs, and take charge of its banking operations. This would not only be exercising powers granted to the plaintiff neither expressly nor by implication, but those which are clearly opposed to the manifest spirit and intent, if not to the language of of the statute. This court has uniformly adhered to the doctrine announced in *Straus v. Eagle Insurance Co.*, 5 Ohio St. 59; that corporations have such powers, and such only, as the act creating them confers; and are confined to the exercise of those expressly granted, and such incidental powers as are necessary to carry into effect those specifically conferred. *Bank of Buffalo v. Toledo F. & M. Ins. Co.*, 12 Ohio St. 601. This principle has recently been most emphatically asserted, both by the Supreme Court of the United States, in *Thomas v. Railroad Co.*, 101 U. S. 71, and by the House of Lords, in *Ashbury Railroad Carriage & Iron Co. v. Riche*, L. R. 7 H. L. 653. It was claimed in argument in both of these cases, that a corporate body may do any act which is neither expressly or impliedly prohibited by its charter; although it was conceded that a stockholder might enjoin the act, where it was not authorized, either expressly or by implication, and that the State by proper process and proceedings might forfeit the charter. But it was held, in the first case, that

the powers of a corporation organized under a legislative enactment are such only as the statute confers, and that the enumeration of them implies the the exclusion of all others; and by the second case, that the contract sued on, being of a nature not included in the Memorandum of Association, was *ultra vires*, not only of the directors, but of the whole company, and which the whole body of shareholders was incapable of ratifying.

Notwithstanding the rule thus prevailing, the act under which both the plaintiff and the defendant were organized, did not leave the right or power of the plaintiff to acquire the title to shares of stock in another corporation, to be determined alone upon the principle of construction which the rule above stated adopted. The right to deal in shares of stock in other corporations is not only not found among the enumerated powers which the act confers upon banks organized under its provisions, but the power, in language, of the most undoubted import, is denied, and its exercise expressly prohibited. It therefore follows that the refusal of the defendant to permit the transfer upon its books to the plaintiff of the two hundred shares of its stock, violated no right of the plaintiff, and consequently created no liability on the part of the defendant. Such refusal did not amount to a conversion of the stock.

Its action in refusing the transfer was but the denial of any right by the plaintiff to be placed in a position to interfere and participate in the control and management of its internal affairs. To the claim of the plaintiff, that it was the duty of the defendant to make the transfer, when the same was demanded, and leave the State to impose the penalty of forfeiture on the plaintiff for a violation of its charter, we do not assent. The cases of *Union National Bank v. Mathews*, 98 U. S. 621 and *Jones v. Guarantee & Indemnity Co.*, 101 U.S. 622, and the cases therein cited, do not support such proposition. The principle of those cases is, that where a corporation is incompetent by its charter to take a title to real estate, a conveyance to it is not void, but voidable only, and that the sovereign alone can object; that the conveyance is valid until assailed in a direct proceeding instituted for that purpose. But they neither, by the principle maintained, nor by the reasoning advanced in support of it, sanction the doctrine that one corporation may buy up the stock of another, and thereby enable itself to interfere with the internal management of its affairs, especially where the power to do so is expressly prohibited by its charter.

In our opinion the petition stated no cause of action against the defendant, and hence laid no foundation for a judgment in favor of the plaintiff. That the plaintiff may have acquired

rights by the pledge received from Foote, to such interest in the bank as said certificate of stock represented is quite true. But what that interest is, if any, we cannot in the present case determine.

Judgment affirmed.

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## RAILROAD COMPANY V. MARSEILLES.\*

SUPREME COURT OF ILLINOIS, 1876.

(84 Ill. 145, 643.)

### *Power of a Corporation to purchase and hold its own Stock.*

*Per Curiam*:—The rule is familiar, and is not contested, that such bodies can only exercise such powers as may be conferred by the legislative body creating them, either in express terms or by necessary implication; and the implied powers are presumed to exist to enable such bodies to carry out the express powers granted and to accomplish the purpose of their creation. Such being the rule, the question arises whether this corporate body might make such a purchase, or is it outside of, and beyond the limit of its power?

Appellant has referred us to a number of cases in our own court, in which it has been held that such organizations have no power to release subscribers for their stock from paying therefore and from their subscriptions; that, when such subscriptions are intended to be fictitious, or the subscribers are released from payment, it operates as a wrong, if not a fraud, on the other subscribers for stock in the same company. But here, the stock had been subscribed, paid for, and certificates thereof issued to, and they were owned and held by, the village at the time this contract was entered into and executed. So, the question is not, whether appellant may release the village from paying for and receiving shares subscribed for, but whether appellant has power to purchase shares of its own stock, paid for, issued to, and held by the village.

In the case of *Taylor v. Miami Exportation Co.*, 6 Ohio, (Hammond) 83, it was held that a banking corporation might lawfully receive shares of its own stock from a solvent debtor in

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\*See *Clapp v. Peterson*, 104 Ill. 26, (1882.) *Trevor v. Whitworth*, L. R. 12 App. Cases 409. (1887.)



discharge of his indebtedness. The court went further, and held that, where a large number of shares had been issued to enable the holder to vote for certain persons for directors at an approaching election, and, after the holder had thus voted, the money paid for the shares was returned to him, and he restored the shares to the bank, as there was no loss sustained by the transaction, and the result of the election was not changed, and whilst the court condemned the transaction, it held that equity could afford no relief, as no one had been injured. It was also held in that case that, where the shares of the company were transferred to it in payment of such indebtedness, the corporation might hold and sell it as it did its other property.

In the case of the *City Bank of Columbus v. Bruce*, 17 N. Y. 507, it appeared that the board of directors passed a resolution that all stockholders indebted to the bank on stock notes, by a specified day, might pay such debts to the bank in its shares of stock, at a named per cent, and that not far from half of the stock of the bank was thus surrendered; and the court held, there was no ground for questioning the validity of the transaction; that no rule of common law or any provision of the charter forbade it; and the Ohio case is referred to and approved by the court.

In the case of *Williams v. The Savage Manufacturing Co.*, 3 Md. Ch. R. 452, it was held that banking corporations had the right to take shares of their own stock in pledge or payment of indebtedness to the corporation, and to reissue the same. On the latter proposition *Ex parte Holmes*, 5 Cow., 426 is referred to by the court in its support.

In the case of *The State v. Smith*, 48 Vt. R. 266, it was held, that where a railroad company had purchased 2,350 shares of the stock of the company, the stock did not merge, and the legality of the purchase seems to be recognized by the court. And in further support of the rule see Angell & Ames on Corp. § 280, where it is said it is one of the corporate powers that may be legally exercised.

If, then, as in the cases above referred to, a bank may purchase and hold its own shares, no reason is perceived why a railroad corporation may not do the same thing, and the case of the *State v. Smith* (*supra*) was the purchase of stock by a railroad company, and of shares of its own stock. These authorities, we think, fully recognize the power of the directors of a company, when not prohibited by their charter, to purchase shares of stock of their company. It falls within the scope of the power of the directors to manage and control the affairs and property of the company for the best interests of the stockholders, and when they have thus acted, we will presume, until the contrary

is shown, that the purchase was for legitimate and authorized purposes.

If it were shown that the purchase was made to promote the interests of the officers of the company alone, and not the stockholders generally, or if for the benefit of a portion of the stockholders and not all, or for the injury of all or only a portion of them, or if it operated to the injury of creditors, or would defeat the end for which the body was created, or if it was done for any other fraudulent purpose, then chancery could interfere. In such case, *Melvin v. The Lamar Ins., Co.*, 80 Ill. 446, and other cases in chancery referred to in appellant's brief, would apply, but the defence cannot be made a law. The case of *Belford Railroad Co. v. Bower*, 48 Pa. St. R. 29 was in a court where there is no distinction between actions at law and suits in equity, and we presume the defence was allowed by the application of equitable principles, and the cases in the British courts which seem to bear on the question were in equity. Whatever may be the rights of stockholders or creditors, if there are any, relief can only be had in equity, and by a stockholder or other *cestui que trust*.

The judgment of the court below will, therefore be affirmed.

Judgment affirmed.

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## COPPIN V. GREENLESS COMPANY.

SUPREME COURT OF OHIO, 1882.

(38 Ohio St. 275.)

### *Power of a Corporation to Purchase and Hold its Own Shares.*

McIlvaine J.:—Whether the defendant corporation was bound by its executory agreement with the plaintiff to purchase shares of its own stock, under the circumstances detailed in the petition, was, undoubtedly, the question upon which the case turned in the district court.

The power of a trading corporation to traffic in its own stock, where no authority to do so is conferred upon it by the terms of its charter, has been a subject of much discussion in the courts; and the conclusions reached by different courts have been conflicting. Of course, cases wherein the power is found to exist by express or implied grant in the charter, furnish no aid in the solution of the question before us; unless the claim of the plaintiff

can be sustained, that such power was conferred on the defendant by section 63 of the corporation act of 1852 (S. & C. 301), as amended, which confers on manufacturing corporations the powers enumerated in section 3 of the act, and among others, the power "to acquire and convey at pleasure, all such real and personal estate as may be necessary or convenient to carry into effect the objects of the corporation." We think, however, that this claim cannot be maintained. The sole object of the defendant organization was, "for manufacturing purposes;" and it cannot be said in any just sense, that the power to acquire or convey its own stock was either necessary or convenient "for manufacturing purposes."

The doctrine that corporations, when not prohibited by their charters may buy and sell their own stocks, is supported by a line of authorities; and prominent among them may be mentioned the cases of *Dupee v. Boston Water Power Co.*, 114 Mass. 37 and *C. P. and S. R. R. v. Co. Marseilles*, 84 Ill. 145. But nevertheless, we think the ~~decided weight of authority both in England and in the United States, is against the existence of the power unless conferred by express grant or clear implication.~~ The foundation principle upon which these later cases rest is that a corporation possesses no powers except such as are conferred upon it by its charter, either by express grant or necessary implication; and this principle has been frequently declared by the Supreme Court of this State; and by no court more emphatically than by this court. It is true, however, that in most jurisdictions, where the right of a corporation to traffic in its own stock has been denied, an exception to the rule has been admitted to exist, whereby a corporation has been allowed to take its own stock in satisfaction of a debt due to it. This exception is supposed to rest on a necessity, which arises in order to avoid loss; and was recognized in this State as early as *Taylor v. Miami Exporting Co.*, 6 Ohio, 176, and has been incidentally referred to as an existing right since the adoption of our present constitution. *State v. Building Association*, 35 Ohio St. 258.

But, however, that may be, the right of a corporation to traffic in its own stock, at pleasure, appears to us to be inconsistent with the principle of the provisions of the present constitution, article 13, section 3, which reads as follows: "Dues from corporations shall be secured by such individual liability of stockholders, and other means, as may be prescribed by law; but in all cases, each stockholder shall be liable, over and above the stock by him or her owned, and any amount unpaid thereon, to a further sum, at least equal in amount to such stock." Now, it is just as plain, that a business or trading corporation cannot exist

without stock and stockholders, as it is that the creditors of such corporations are entitled to the security named in the constitution. *State ex-rel. Att'y-Gen. v. Sherman* 22 Ohio St. 411. The corporation itself cannot be a stockholder of its own stock within the meaning of this provision of the constitution. Nobody will deny this proposition. And if a corporation can buy one share of its stock at pleasure, why may it not buy every share? If the right of a corporation to purchase its own stock at pleasure exists and is unlimited, where is the provision intended for the benefit of creditors? This is not the security to which the constitution invites the creditors of corporations. I am aware, that the amount of stock required to be issued is not fixed by the constitution or by statute, and also that provision is made by statute for the reduction of the capital stock of corporations; but of these matters, creditors are bound to take notice. They have a right, however to assume that stock once issued, and not called back in the manner provided by law, remains outstanding in the hands of stockholders liable to respond to creditors to the extent of the individual liability prescribed. In this view it matters not whether the stock purchased by the corporation that issued it, becomes extinct, or is held subject to be reissued. It is enough to know that the corporation, as purchaser of its own stock does not afford to creditors the security intended. And surely, if the law forbids the organization of a corporation without stock, because the required security is not furnished, it cannot be, that having brought the corporation into existence, it invests it with power to assume, at pleasure, the identical character or relation to the public, that was an insurmountable objection to the giving of corporate existence in the first place.

Plaintiff in error lays much stress on the averments in the petition, that it had been the custom of the corporation that its officers and others actively engaged in its service, should be holders of shares of its stock, and upon ceasing to be connected with the company such persons had been accustomed to sell, and the company to buy such stock; and that the plaintiff had purchased the stock for the price of which suit was brought while in the employment of defendant.

We cannot see why these averments should take the case out of the general rule.

If it were averred that the plaintiff had purchased this stock from the defendant, or from others, under an agreement with the company that it would buy the same from him when he quit its employment or if the contract of purchase by the defendant had been executed, very different questions would arise.

It is not even averred, that the plaintiff relied upon such custom either in making the purchase or the sale of the stock; so that, in

fact, he is unaffected by the alleged custom. But if such custom had been relied on by the plaintiff when he purchased the stock, it would not have made the executory contract of the defendant to buy the stock binding, which, without such custom would be void. The usage of a corporation does not become the law of its existence, or the measure of its powers. The general law of the State, of which all persons are presumed to have knowledge, is the source and limit of all its powers and duties; and these cannot be varied either by usage or contract. The doctrine of estoppel has no application in the case. Nor is there any such equity in the case as would have arisen between the parties in case the contract had been executed.

Judgment affirmed.

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EASUN V. BUCKEYE BREWING CO.

U. S. CIRCUIT COURT, N. D. OHIO, W. D. 1892.

(51 Fed. Rep. 156.)

*Powers of Corporation to hold stock in Another Corporation.*

This is an action instituted by the plaintiff to recover damages for the failure of the defendants to comply with the provisions of a contract by the terms of which the Buckeye Brewing Co. obligated itself to sell to the vendee certain brewing property.

The purchaser as a consideration for the sale agreed to pay the vendor the sum of \$860,000, whereof "the sum of \$10,000 shall be paid in cash by way of a deposit; the further sum of \$334,000 shall be paid in cash on or before the completion of the purchase; the further sum of \$258,000, by issue to the vendors or as they may appoint, of six per cent. debenture bonds of an English joint stock company, proposed to be formed by the purchaser, herein after referred to as the 'company,' provided the total amount of such debenture bonds shall not exceed ninety-thousand pounds; and the balance of \$258,000 by the allotment to the vendors of ordinary shares of the company of that equivalent, nominal value, such shares to be deemed paid up."

The Buckeye Brewing Co. refused to perform its part of the contract.

Ricks, District Judge: \*\*\* In the view which we take of this case, it is only necessary to consider the question of whether or not this contract sued upon was *ultra vires*. It is well settled in

Ohio that corporations have such powers, and such only, as the act creating them confers; and are confined to the exercise of those expressly granted, and such incidental powers as are necessary to carry into effect those specifically conferred. Under this construction of the statute, it was clearly settled in the case of *Franklin Bank v. Commercial Bank*, 36 Ohio St. 350, that one corporation cannot become the owner of any portion of the capital stock of another corporation, unless authority to become such is clearly conferred by the statute. The provisions of this contract clearly contemplated that the Buckeye Brewing Company, which, so far as the pleadings before us show, was, at the time of making such contract, not only a solvent corporation, but a prosperous and profitable one, should sell and dispose of its plant and all its assets, and a very large part of the consideration for such sale was to be stock and bonds in an English corporation to be organized to carry on the business of the vendee. The provisions of the contract specified as to the rate of interest such bonds should carry, and the dividend such stock should pay. By implication it is fair to infer that it was contemplated that the Buckeye Brewing Company, as a corporation, should continue, for the purpose of collecting the interest on these debenture bonds, the dividends on the stock of the new corporation, and to distribute the same among the shareholders of said Buckeye Brewing Company. It was therefore to continue its business as a corporation, not for the purpose of carrying out the objects for which it was organized, viz., the business of a brewing company, but for the purpose of owning stock in a new corporation, and the extent that ownership of such stock involved participating in the management of that corporation it was to assist in carrying on the business of another corporation. There was no such exigency in the business of this corporation as to make such sale of its property and change in the nature of its corporate business necessary for the protection of its stockholders. Counsel for the plaintiff have cited many cases in which the courts of several of the states, under statutes very similar to those of Ohio, have held that corporations had a right to own and control the stock of other corporations, but in every such case to which our attention has been called such power was conceded to the corporation as incident to its inherent right to protect its shareholders from loss, owing to some peculiar exigency in the affairs of the corporation. An insolvent corporation, contemplating voluntary dissolution by consent of its shareholders, might have a right to dispose of its property, and accept, in whole, or in part, for the purchase price thereof, stock in another corporation; this stock to be either sold, and the proceeds thereof distributed to the creditors, or to be apportioned in kind to such creditors or stockhold-

ers as the terms of dissolution might provide. A receiver appointed to manage the affairs of an insolvent corporation and to close out its business might be authorized to dispose of its assets, and receive in payment therefor stock in the corporation, to be disposed of as the court might order in the distribution of its assets. But in all these cases there must be some stringency or emergency to justify this departure from the ordinary course of the business of the corporation. But in this case no such emergency existed. As before stated, the corporation was doing a flourishing business. Its plant and good will and business were considered so desirable that the vendee agreed to pay therefore the large consideration specified in the contract. This sale could undoubtedly have been made for cash and deferred payments. The purchase price might not have been so great upon such a basis, but still would have been adequate. As no emergency existed to compel this sale, and the transaction was purely voluntary on the part of the corporation, there is no reason why it should be permitted to violate the well settled principles of law by taking stock in a new corporation, and thereby enhancing the consideration which it was to receive. Public policy discourages such transactions. As the supreme court of Ohio has well said, in the case in 36 Ohio St., above referred to:

"Were this not so, one corporation, by buying up the majority of the shares of the stock of another, could take the entire management of its business, however foreign such business might be to that which the corporation so purchasing said shares was created to carry on. A banking corporation could become the operator of a railroad, or carry on the business of manufacturing, and any other corporation could engage in banking by obtaining control of the bank's stock. Nor would this result follow any the less certainly if the shares of stock were received in pledge only to secure the payment of a debt, provided the shares were transferred on the books to the name of the pledgee. A person in whose name the stock of the corporation stands on the books of the corporation, is as to the corporation, a stockholder, and has the right to vote upon the stock."

All these objections apply with full force to the transactions under consideration before us. There is no reason why there should be a departure from these well-settled rules in this case. There are no creditors whose interests are to be protected by upholding this sale. There are no unfortunate shareholders who are liable to be assessed for unpaid debts under the statutes of the state. There was, in fact, no emergency to justify any such unauthorized transactions on the part of the Buckeye Brewing Company. The plaintiff does not sustain such a relation to this

contract as entitles him to any exemption from the application of these principles of law. He must be held to have dealt with this corporation with knowledge of its corporate powers. They were such as was conferred by the laws of Ohio, of which he had the same notice as the defendant and all persons dealing with it. The want of power on the part of defendant to make such a contract prevents the plaintiff from either enforcing it in an action for specific performance or recovering damages for its breach. *Coppin v. Greenlees & Ransom Co.*, 38 Ohio St. 275. For the reason stated we think the contract *ultra vires*. It cannot, therefore, be enforced, and this proceeding must fail. The other grounds insisted upon in the demurrer it will not be necessary to notice. The demurrer must be sustained, and the petition dismissed.



## CHAPTER VI.

## ULTRA VIRES ACTS OF CORPORATIONS.

## BISSELL V. RAILROAD COMPANY.\*

NEW YORK COURT OF APPEALS 1860.

(22 N. Y. 259.)

*Ultra Vires.*

Comstock, C. J.: A general statement of the plaintiff's case is, that the two corporations defendant were jointly engaged in the business of carrying passengers and freight between Chicago and Lake Erie, through a part of the State of Illinois, and through the states of Indiana and Michigan, by three connected railroads which they owned or controlled, and the business of which was managed under a consolidated arrangement, which had been in force between the defendants, for some time previous to the injury complained of; that, being so engaged, they undertook and assumed to carry him, the plaintiff, as a passenger, from Chicago, or a point near that place, eastward over the consolidated line of road; that he took his seat in their cars accordingly, and that, during the transit, he was injured by an accident which happened through their carelessness and neglect. Assuming the truth of this statement, there is no doubt of the plaintiff's right to recover.

But the defendants deny the legal truth of these facts, because one of the companies was chartered by the legislature of Michigan, with power to build a road in that state, and the other by the legislature of Indiana, with power to build one in that state. They both insist, that they had no right or power, under their respective charters, to consolidate their business in the manner stated, and especially, that they could not legally, either separately or jointly, acquire the possession and use of a connecting road in the State of Illinois, and undertake to carry passengers or freight over the same. They do not deny that their boards of directors and agents, duly authorized to wield all the powers which the corporations themselves possessed, entered into the arrangements which have been mentioned, nor that, in the execution of those arrangements, they made the contract with the

\*Day v. Spiral Springs Buggy Co. 57 Mich. 146 (1885); Insurance Company v. McClelland, 9 Colo. 11, (1885); Bradley v. Ballard, 55 Ill. 413, (1870); Northwestern Packet Co. v. Shaw, 37 Wis. 656, (1875); Whitney Armes Co. v. Barlow, 68 N. Y. 62, (1875).

plaintiff to carry him as a passenger, nor do they deny that they received the benefit of that contract, in the customary fare which he paid. Their defence is, simply and purely, that they transcended their own powers, and violated their own organic laws. On this ground, they insist that their business was not, in judgment of law, consolidated; that they did not use and operate a road in Illinois; that they did not undertake to carry the plaintiff over it; and did not, by their negligence, cause the injury of which he complains; but that all these acts and proceedings were, in legal contemplation, the acts and proceedings of the natural persons who were actually engaged in promoting the same.

Can, then, two railroad corporations, having connecting lines, thus unite their business, for the purpose of promoting their common interest; charter another connecting road, in furtherance of the same policy; hold themselves out to the public as carriers over the whole route; enter into contracts accordingly; receive the benefit of those contracts; and then, when liabilities arise, interpose the violation of their own charters to shield them from responsibility? Such a defence is shocking to the moral sense, and although it appears to have some support in judicial opinions, I think, it has no foundation in the law.

The doctrine has certainly been asserted on some occasions, that, in all cases where the contracts and dealings of a corporation are claimed to be invalid for want of power to enter into the same, a comparison must be instituted between those contracts and dealings and the charter, and, if the charter does not appear to embrace them, then that they must be adjudged void to all intents and purposes, and in all conceivable circumstances. The reasoning on which this doctrine has been usually claimed to rest, denies, in effect, that corporations can, or ever do, exceed their powers. They are said to be artificial beings, having certain faculties given to them by law, which faculties are limited to the precise purposes and objects of their creation, and can no more be exerted outside of those purposes and objects, than the faculties of a natural person can be exerted in the performance of acts which are not within human power. In this view, these artificial existences are cast in so perfect a mould, that transgression and wrong become impossible. The acts and dealings of a corporation, done and transacted in its name and behalf, by its board of directors, vested with all its powers, are, unless justified by its charter, according to this reasoning, the acts and dealings of the individuals engaged in them, and for which they alone are responsible. But such, I apprehend, is not the nature of these bodies; like natural persons, they *can overleap the legal and moral restraints imposed upon them: in other words they are capable of doing wrong.* To say that a corporation has no

right to do unauthorized acts, is only to put forth a very plain truism; but to say that such bodies have no power or capacity to err, is to impute to them an excellence which does not belong to any created existences with which we are acquainted. The distinction between power and right is no more to be lost sight of in respect to artificial, than in respect to natural persons.

I think, this doctrine of theoretical perfection in corporations would convert them practically into most mischievous monsters. A banking institution, through its board of directors, may invest its funds in the purchase of stocks or cotton, and every holder of its stock may acquiesce, expecting to profit by the speculation. If the enterprise is successful, the corporation and its stockholders gain by the result; if a depression occurs in the market, and disaster is threatened, the doctrine that a corporation can never act outside of its charter and enables it to say, "this is not our dealing," and the money used in the adventure may be unconditionally reclaimed from whatever parties have received it in exchange for value; while the injured dealer must seek his remedy against agents perhaps irresponsible or unknown. Corporations may thus take all the chances of gain, without incurring the hazards of loss. Familiar maxims of the law must be reversed. In the relation of private principle and agent, the adoption of an agent's unauthorized dealing is equivalent to an original authority; and the adoption is perfect when the principal receives the proceeds of that dealing. Corporations may practically act in the same manner. The proceeds of unauthorized adventures may be received and become blended with their legitimate business and funds, so as to be wholly undistinguishable; but as the adventures themselves were, in judgment of law, impossible, considered as corporate transactions, so they cannot become possible upon any principle of ratification or estoppel. If we say there is an utter absence of power or faculty to engage in the dealing, it is a self-evident proposition that no rule of estoppel can change the result.

It is not uncommon in charters of corporations, to lay express prohibitions upon them, as a limitation of their powers, having in view the maintenance of some public policy; as, for example, prohibitions relating to the currency of the State. If they violate these prohibitions, they have been supposed to be public offenders, and on that ground, the law has always denied to them its remedial processes, either in affirmance or disaffirmance of their unlawful contracts; thus regarding them as private offenders are regarded. But this rule of law must be overthrown, if we admit this theory of constitutional inability in corporations to overstep the limits of rightful power.

In the case of *The Life and Fire Insurance Company v. Mechanics' Fire Insurance Company*, 7 Wend. 31, it was contended, that a certain corporate transaction, if unlawful, was to be regarded as the act of the agents or officers of the company, and not of the company, and, therefore, that the company should be allowed to recover back the money or property improperly disposed of. That doctrine was refuted by Mr. Justice Sutherland, in this language: "This would be a most convenient distinction for corporations to establish,---that every violation of their charter, or assumption of unauthorized power on the part of their officers, although with the full approbation of their directors, is to be considered the act of the officers, and is not to prejudice the corporation itself. There would be no possibility of ever convicting a corporation of exceeding its powers, and thereby forfeiting its charter, or incurring any other penalty, if this principle could be established." These remarks suggest an unanswerable argument against the doctrine. Why, it may be asked, does the law provide the remedy by *quo warranto* against corporations, for usurpation and abuse of power? Is it not the very foundation of that proceeding, that corporations can and do perform acts and usurp franchises beyond the rightful authority conferred by their charters? Most assuredly this is so. The sovereign power of the state interposes, alleges the excess or abuse, and on that ground demands from the courts a sentence of forfeiture.

One of the sources of error, in reasoning upon legal as well as other questions, is inexactness in the use of language, or perhaps in the imperfectness of language to express the varieties of thought. It is a self-evident truth, that a natural person cannot exceed the powers which belong to his nature. In this proposition, we use words in their literal and exact sense. In the same sense, it is a truth, equally evident, that a corporation cannot exceed its powers; but this is only asserting that it cannot exercise attributes which it does not possess. As an impersonal being, it cannot experience religious emotion, nor feel the moral sentiments. Corporations are said to be clothed with certain powers enumerated in their charters, or incidental to those which are enumerated, and it is also said, they cannot exceed those powers; therefore, it has been urged, that all attempts to do so are simply nugatory. The premises are correct, when properly understood; but the conclusion is false, because the premises are misinterpreted. When we speak of the powers of a corporation, the term only expresses the privileges and franchises which are bestowed in the charter; and when we say it cannot exercise other powers, the just meaning of the language is, that as the attempt to do so is without authority of law, the performance of unauthorized acts is a usurpation, which may be a wrong to the state, or, perhaps to the

shareholders. But the usurpation is possible. In the same sense, natural persons are under the restraints of law, but they may transgress the law, and when they do so, they are responsible for their acts. From this consequence, corporations are not, in my judgment, wholly exempt. The privileges and franchises granted are not the whole of a corporation. Every trading corporation aggregate includes an association of persons having a collective will, and a board of directors or other agency in which that will is embodied, and through which it may be exerted in modes of action not expressed in the organic law. Thus, like moral and sentient beings, they may and do act in opposition to the intention of their creator, and they ought to be accountable for such acts.

A great variety of cases might be supposed, in which this doctrine of corporate exemption from liability could not be defended, upon any rule of reason or principle of justice. But perhaps none of them would afford a more persuasive illustration than the one now under consideration. Let us look at the facts and consider the results. These corporations had boards of directors, in whom were vested every power, faculty, or function which belonged to the bodies they represented. We have then no question in the law of agency; for the agents, if that be the proper term, had all the powers of the principals; indeed, in an important sense they were the principals; because their authority was not received by delegation from any other principal. These boards proceeded to consolidate the two lines of road, and they included in the scheme another connecting road. This being done they entered into all the relations of carriers, with the public, and the entire business of both companies was thus conducted, for a period of several years, with no complaint on the part of the State sovereignties which granted the charters, and none on the part of the shareholders. All the gains and profits of the business were received to the use of the corporations, and it is to be assumed that the shareholders were benefited thereby. The question arises, where were these companies, and what were they doing, during all this period? The question would be the same, if that mode of conduct were to continue, without limit of time. If the acts mentioned were in excess of the powers granted, and if we concede the doctrine that such acts are, in all circumstances, to be imputed to the agents who perform them, the conclusion follows, that the corporations became virtually extinct by non-user of their franchises. If the business thus conducted was not the business of the companies, they were engaged in none whatever, and thus, practically, if not legally, ceased to exist. If it was the business of the directors, as natural persons, then, those persons must be deemed not only to have taken a wrongful possession of all the estate and funds of the

corporations they professed to represent, but also to have usurped their franchises, and to have stolen their corporate names and seals. If this be the legal interpretation of the course of dealing and conduct actually carried on under the acts of incorporation passed by the Legislatures of Michigan and Indiana, then the companies might have been proceeded against by those States, not on the ground of a usurpation of powers and privileges which did not belong to them, but for a total non-user of the franchises which did belong to them; while on the other hand, writs of *quo warranto* might have been issued against the individual directors and agents, for usurping corporate rights without any charter at all. 16 Wend. 655; 23 Id. 193; 3 Bl. Com. 263.

These conclusions are not founded in any known principle or practice, and they are totally opposed to the facts of the case. In rejecting them, we must also reject the theory of corporate perfection and immunities on which they were based; and we are compelled to hold, that those companies, as legal and accountable persons, engaged themselves in the business of carrying passengers and freight, under and according to the arrangements which have been mentioned, and thereby placed themselves in that relation to the public, and to the plaintiff in particular, which is the subject of the present controversy.

But the doctrine, that corporations can never be bound by engagements not justified by the grant of power from the State, is next defended on a different ground. Although it be conceded, that they are present and acting as legal persons, or entities, when such engagements are entered into, it is said that all contracts in excess of the rightful power possessed by corporations are illegal, and therefore void. This is an argument totally different from the one which has been so far examined, because it necessarily imputes the making of the contract to the corporate person or being; whereas the doctrine which I have endeavored to refute denies that proposition. The very point of the supposed illegality consists, or, at least, it may consist, in the performance of acts perfectly lawful in themselves, but which being done by a corporation and not by individuals, are pronounced illegal, because they are so done without authority contained in the charter.

But, is it true, that all contracts of corporations for purposes not embraced in their charters are illegal, in the appropriate sense of that term? This proposition I must deny. Undoubtedly, such engagements may have the vices which sometimes infect the contracts of individuals. They may involve a *malum in se* or a *malum prohibitum*, and may be void for any cause which would avoid the contract of a natural person. But where no such vices exist, and the only defect is one of power, the contract cannot be

void, because it is illegal or immoral. Such a doctrine may have some slight foundation in the earlier English railway cases, *East Anglian Railway Co. v. Eastern Counties Railway Co.*, 11 C. B. 775, 7 Eng. Law. & Eq. 509; *McGregor v. Deal and Dover Railway Co.* 18 Q. B. 618; but it was never established, and is not now received in the English courts. *Mayor of Norwich v. Norfolk Railway Co.*, 4 El. & Bl. 397; *Eastern Counties Railway Co. v. Hawkes*, 5 H. L. C.347.

The books are full of cases upon the powers of corporations, and the effect of dealing in a manner and for objects not intended in their charters; but with the slight exception named, there is an entire absence, not only of adjudged cases, but of even judicial opinion or *dicta*, for the proposition that mere want of authority renders a contract illegal. Such a proposition seems to me absurd; the words *ultra vires* and illegality represent totally different and distinct ideas. It is true, that a contract may have both these defects, but it may also have one without the other. For example, a bank has no authority to engage, and usually does not engage, in benevolent enterprises. A subscription, made by authority of the board of directors and under the corporate seal, for the building of a church or college, or an almshouse, would be clearly *ultra vires*, but it would not be illegal; if every corporator should expressly assent to such an application of the funds, it would still be *ultra vires*, but no wrong would be committed, and no public interest violated. So a manufacturing corporation may purchase ground for a school-house, or a place of worship for the intellectual, religious, and more improvement for its operatives; it may buy tracts and books of instruction for distribution amongst them. Such dealings are outside of the charter; but, so far from being illegal or wrong they are in themselves benevolent and praiseworthy. So a church corporation may deal in exchange; this, although *ultra vires*, is not illegal, because dealing in exchange is, in itself, a lawful business, and there is no state policy in restraint of that business.

To illustrate the subject in another manner: An agent may make a contract in the name and behalf of his principal, but not within the scope of his agency. If the consideration and purpose of such a contract be lawful, it may be void as against the principal, but not on the ground of illegality. A corporation is not an agent of the state, nor, in any strict sense, of the shareholders; but it derives its powers from the state, and it may transcend those powers for purposes which in themselves considered, involve no public wrong. Contracts so made may be defective in point of authority, and may contemplate a private wrong to the shareholders; but they are not illegal, because they violate no public

interest or policy. My meaning, in short, is that the *illegality* of an act is determined in its quality, and does not depend on the person or being which performs it.

There has been, I think, some want of reflection, even in judicial minds, upon the reasons and policy which mainly govern in the granting of charters to corporations, with certain specified powers and no others. A private or trading corporation is essentially a chartered partnership, with or without immunity from personal liability beyond the capital invested, and with certain other convenient attributes which ordinary partnerships do not enjoy. It is also something more than a partnership, because the legal or artificial person becomes vested with the title to all the estate and capital contributed to be held and used, however, in trust for the shareholders. Now, in a well-regulated unincorporate partnership, the articles entered into by the associates specify the objects of their association. But, suppose the same associates desire a charter of incorporation for the more convenient prosecution of the same business, and obtain one. We shall find it to contain the like specification, which becomes the grant of power from the sovereign authority of the state. I am speaking of powers and privileges granted which are not, in their essential nature, corporate or public franchises, as distinguished from the private enterprises which any class of citizens may embark in; and, with the exception of municipal or governmental charters, the class of powers here referred to will be found to cover nearly the whole field of corporate rights. It is not difficult, then, to see, the reason and policy which underlie such grants. The associates ask for a charter, in order to carry on their business with greater advantages; and the same reason exists for a specification of the purposes of their organization, as in the case of an association without a charter. The charter takes the place of the articles of agreement, and becomes the appropriate rule of action. No public interest or policy is involved, because the objects of the grant are not of a public nature; the powers and rights specified are identical with those which any private person or association of persons may exercise. If those who manage the concerns of a simple partnership deal with the funds in a manner or for purposes not specified, their acts are *ultra vires*; and if the directors of such corporation as I am here speaking of, do the same thing, their acts are also *ultra vires* in the same sense and no other. To apply the word "illegality" to such transactions, is to confound things of a totally different nature. It is only private interests which are affected by them; and there is no statute or rule of the common law by which they become public offences.



In every treatise upon the law of contracts—and there are many of them—we shall find an enumeration of such as are immoral or illegal; but amongst them cannot be found a specification of the promise or agreement of a corporation, founded on a lawful consideration, and to do that which in itself is lawful to be done, although not within the powers granted. It has always been supposed, and to that effect are all the authorities, that contracts are illegal either in respect to the consideration or the promise. Where both of these are lawful and right, the maxim, “*ex turpi contractu non oritur actio*,” can have no application. The incapacity of the contracting party, whether it be a corporation, an infant, a *feme covert*, or a lunatic, has nothing to do with the legality of the contract, in that sense of the word which is now under discussion. So, in the treatises upon corporations, we shall find their rights and privileges to be very extensively considered, but nowhere an intimation that their dealings outside of their charters are deemed illegal for that cause.

Even the proceeding against them by *quo warranto*, for the exercise of ungranted powers, will illustrate the subject. This is a civil, and not a criminal proceeding, and its object is purely and solely to try a civil right. 2 Kyd on Corporations, 439; Angell & Ames, 686; 1 Serg. & Rawle, 385; 3 Dallas, 490; 1 Blackf. 267. Our statute on this subject makes it the duty of the attorney-general to institute the proceeding, under leave of the court, when the case is one of public interest, but, in other cases, only at the instance of private parties claiming to be aggrieved by the abuse of power, and on security being given to indemnify the state 2 R. S. 583, §§ 39, 40. In any case, whether the suit be founded on the alleged usurpation of a public or corporate office, or on the non-user or misuser of the franchises granted to a corporation, it is purely a civil right which is tried and the judgment is not penal, but simply one of ouster from the right claimed.

The legislature may, and sometimes does, expressly prohibit the doing of certain acts by corporations, having in view the promotion of some particular policy of the state, and may declare such acts to be public offenses, to be punished by fine or imprisonment of the parties engaged in them. There are such laws in regard to incorporated as well as private banks, the object of which is to protect the currency of the state. But where there are no such penalties or prohibitions, and the dealings of a corporation have no relation to state policy, but are such as all mankind may freely engage in, the law has provided no punishment for such dealings, because it does not regard them as a violation of its principles and enactments, in any sense which is material to the present inquiry. I do not deny, that there is, in a different

sense, a legal wrong, in the misapplication of the corporate capital and funds; and so there is in every breach of trust or violation of contract. But the true inquiry here is whether it belongs to the class of public, as distinguished from private wrongs, so that the guilty party may set it up in avoidance of just obligations; and whether the courts must, in all circumstances, accept that defense, without regard to the situation and rights of the other party. I cannot believe such to be the rule of reason or of law.

Let us now concede that the unauthorized contracts of a corporation are illegal in the sense contended for; it by no means follows, that they are never to be enforced. An agreement declared by statute to be void cannot be enforced, because such is the legislative will; but when, without any such declaration, it is simply illegal, it is capable of enforcement, where justice plainly requires it. Circumstances may, and often do, exist, which estop the offender from taking advantage of his own wrong. The contract may be entered into on the other side, without any participation in the guilt, and without any knowledge even of the vice which contaminates it. An innocent person may part with value, or otherwise change its situation, upon the faith of the contract. A railroad corporation, for example, may purchase iron rails, and give its obligation to pay for them, with a design to sell them again on speculation, instead of using them for continuing its track; such a transaction is clearly unauthorized, and, is therefore, said to be illegal. But if the corporation is deemed to make the contract,—in other words, if, as I have above shown, it is a legal possibility for corporations to make contracts outside of their just powers, how can its illegality be set up against the other party, who knows nothing of the unlawful purpose? So, an incorporated bank may purchase land, having power to do so for a banking-house, but actually intending to speculate in the transaction. This is also *ultra vires*; but can the want of authority be interposed, in repudiation of a just obligation to pay for the same land, the vendor not being *in pari delicto*? Such a doctrine is not only shocking to the reason and and conscience of mankind, but it goes far beyond the law in regard to the illegal contracts of private individuals.

As I am not contending that the unauthorized dealings of a corporation are never to be questioned, the object of this discussion has been to ascertain the true ground on which they can be impeached, where they are not attended by the vices which are fatal to private contracts also. I have shown, I trust—1. That such dealings are possible in law, as they often take place in fact; in other words, that it is in the nature of these bodies to overleap the restraints imposed upon them. 2. That a transgression of this nature is a simple excess of power (using that word to ex-

press the rules of action prescribed in their charters, and by which they ought to regulate their conduct), but is not tainted with illegality, so as to avoid the contract or dealing, on that ground. This proposition, it seems hardly necessary to repeat, is applied only to transactions which involve or contemplate no violation of the code of public or criminal law, but on the contrary, are innocent and lawful in themselves. 3. Even illegal contracts, in the proper sense, are not, universally and indiscriminately, to be adjudged void; and especially this is not so, where the offender alleges his own wrong to avoid just responsibility, the other party being innocent of the offence.

If these negative conclusions cannot be denied, it follows, that contracts and dealings such as I have been speaking of, are to be condemned by the courts only on the ground that they are a breach of the duty which private corporations owe to the stockholders to whom the capital beneficially belongs. It is the undoubted right of stockholders to complain of any diversion of the corporate funds to purposes unauthorized in the charter. This, as a general principle, cannot be too strongly asserted; and by this principle justly applied to particular instances, the question in such cases is to be resolved. The original subscribers contribute the capital invested, and they and those who succeed to their shares are always, in equity, the owners of that capital. But, legally, the ownership is vested in the corporate body, impressed with the trusts and duties prescribed in the charter; in these relations we have the only true foundation of the plea of *ultra vires*. That term is of very modern invention, and I do not think it well chosen, to express the only principle which it can be allowed to represent in cases of this nature. It is not to be understood as an absolute and peremptory defence, in all cases of excess of power, without regard to other circumstances and considerations. It is not to be looked upon as a plea which denies the actual exertion of corporate power, when a corporation enters into an engagement which, according to its charter, it ought not to make; but because such was the nature of the contract, it presents the breach of trust or duty to the shareholders as an excuse for the non-performance. And I do not deny the validity of this excuse, in many cases, I may say, in all cases, where it can be received without doing greater injustice to others. If the person dealing with a corporation knows of the wrong done or contemplated, and he cannot show the acquiescence of the shareholders, he ought not to complain, if he cannot enforce the contract. Aside from the law of corporations, agreements which involve or propose a violation of trust will not be enforced by the courts, where no greater equities demand it. Corporate bodies are more than mere agents; they are more than a partner who manages as

the agent of his associates; their powers are undelegated. They are the legal owners of the capital, or estate, and they have capacity to deal with it in contravention of duty or trust.

But the equitable rights of shareholders will enable them, in many circumstances to claim the affirmative interposition of the courts, to arrest an unauthorized course of dealing, or to prevent a threatened diversion of the capital to improper uses. Of this character are many of the cases usually cited, to prove that corporations cannot exceed their powers. *Dodge v. Wolsey*, 18 How. (U.S.) 331; *Rolf v. Rogers*, 3 Paige, 154; *Angell & Ames on Corp.* 424, 4th ed., and cases cited. So, too, it is plain, without citing authority, that a stockholder, who can show that he has sustained a pecuniary loss by such a use of the capital, may have his redress in damages against the individuals who commit the wrong, unless he has himself acquiesced. These are extensive, and, it would seem, ample remedies, to prevent or redress the abuse of power; and it appears to me a much higher and better policy, that the private shareholders should be confined to these remedies, than to sacrifice the interests of the rest of the community, by conceding to these bodies absolute immunity, whenever power is thus abused.

But the principles which belong to this question need not present that naked alternative. In many cases, no injustice will be done by receiving the plea of *ultra vires*, when defensively interposed by the corporation itself. But these are cases where a want of good faith can be imputed to the dealer, and where the defence, if allowed, will leave the parties substantially in the enjoyment of their previous rights. An artificial, not less than a natural person, having the title and possession of an estate which in equity, belongs to others, and entering into engagements inconsistent with duty or trust, should have a *locus penitentæ*, where it can be allowed without manifest wrong to others. It may be difficult to lay down a rule so general and so exact as to include every case; but the principles and analogies of the law will be sufficient for the solution of such questions as they arise. Justice, not only in this, but in very many other cases of constant occurrence, can be administered according to law, if I have succeeded in showing, negatively, that a comparison of the charter of a corporation with what it actually does, is not always the test of liability.

It is said that there will be no restraint upon the acts and dealings of corporate bodies if we uphold them when in excess of rightful authority. To this I answer, that the most ample restraints will be found in the principles here advocated; while, on the other hand, if we concede to corporations immunity in all cases, when they do wrong, we invite and reward the very abuse. It is also

said, in order to render this doctrine less offensive to the reason and conscience, that the innocent dealer may, upon the voidness of the contract and a disaffirmance of it, recover back the value or consideration with which he has parted. This position necessarily concedes that the corporation, as a legal person, made the unauthorized contract, and received the money, or value, under and according to it; thus overthrowing the main objection to its liability to respond directly upon the contract. It also concedes the innocence of the other contracting party; thus, according to all the analogies of the law, refuting the only other objection (illegality) on which the absolute invalidity of such dealings is claimed to rest: for, surely, after conceding that the corporation actually made the contract, it will not be contended that it can set up, that it ought not to have made it, against an innocent person, who has given up his money or property on the faith of the same contract. But I answer, further, that while in many cases the remedy of a suit in disaffirmance of the agreement, and to recover back the consideration, will be sufficient to prevent wrong, in many others it will be entirely worthless. All collateral securities must fall to the ground with the principal contract, and all its consequences and results. The present case will afford the best illustration. The defendants, in consideration of a trifling sum received from the plaintiff for fare, agreed to perform the service of carrying him in their cars, perhaps some two hundred miles. By the negligent performance of that agreement, they inflicted on him injuries for which a jury has said the proper compensation was \$2,500. This being the measure of damages for the breach of the contract, the absurdity, not less than the injustice, of confining him to the remedy of disaffirmance, because the agreement was *ultra vires*, must be quite apparent.

I have examined these questions with the more attention, because, aside from their bearing on the present controversy, they are of great practical importance. A vast amount of the business of the community has come to be carried on under corporate forms of organization; besides innumerable special charters, we have general laws, which impart corporate attributes to associations formed according to articles of agreement, for a great variety of purposes. When we consider these to be any less than partnerships, with the superadded privileges of succession, of a corporate seal, etc., we forget that corporations are no longer confined to the exercise of public or political franchises. These commercial, manufacturing, and trading bodies are brought into relation with almost every member of the community; and I think it greatly to be desired, that, in laying down the rules of law which are to govern in such relations, we should avoid a

system of destructive technicalities. Those rules should be founded in the principles of justice which are recognized in other and analogous dealings among men.

If we could find the law to be settled in the manner which must be, and is contended for, in order to exonerate the defendants in this case from responsibility, it would be our duty to follow it; but such is not the case. There are, certainly judicial opinions, and some adjudged cases, which countenance the extreme doctrines on which the defence must rest. Among these cases, a leading one is *Hood v. New York & New Haven Railroad Company*, 22 Conn. 502. That case appears to go the length of holding that corporations cannot, and never do, perform acts in excess of their powers. No authority was cited for such a proposition, and it cannot, as I think I have shown, be maintained. Another extreme authority is *Pearce v. Madison and Indianapolis Railroad Company* 21 How. (U.S.) 442, where it appeared that a corporation, in furtherance of its general objects, although, strictly speaking in excess of its powers had entered into an engagement, upon a consideration which it had received and appropriated; it was allowed to repudiate that engagement; but the principles of the question were not much discussed. A considerable number of other cases and *dicta*, of a character less marked, but tending in the same direction, might be referred to.

But, on the other hand, there are well considered authorities which sustain the principles advocated in this opinion. *Steam Navigation Co. v. Weed*, 17 Barb. 378; *Silver Lake Bank v. North*, 4 Johns. Ch. 370; *Chester Glass Co. v. Dewey*, 16 Mass. 94, 102; *Bank of Genesee v. Patchin Bank*, 13 N. Y. 309, 314; *Bulkley v. Derby Fishing Co.*, 2 Conn. 252, 255; *Parker v. Boston and Maine R. R.*, 3 Cush. 107, 108; *Alleghany City v. McClurken et al.*, 14 Penn. St. 83. In the case from 2d Connecticut, it was said: "A corporate body, by transgressing the limits of its charter, may doubtless incur a forfeiture of its privileges and powers, but whoever imagined that it could thus acquire immunity, to the prejudice of third persons?" It will be found, indeed, that such a doctrine is of very modern origin.

In the case from the 14th Pennsylvania, Coulter, J., observed: "It is not universally true, that a corporation cannot bind the corporators beyond what is expressly authorized in the charter. There is a power to contract, undoubtedly; and if a series of contracts have been made, openly and palpably within the knowledge of the corporators, the public have a right to presume that they are within the scope of the authority granted. A bank, which has been long in the habit of doing business of a particular description, would not be exonerated from liability because such

business was not expressly authorized in its charter. The object of all law is, to promote justice and honest dealing, when that can be done without violating principle. I cannot perceive that any principle is violated, by holding a corporation liable for the acts of its accredited agents, even not expressly authorized, when these contracts for a series of times were entered into publicly and in such a manner as, by necessary and irresistible implication to be within the knowledge of the corporators." "One rule of law," he adds, "is often met and counterchecked by another of equal force, so that, although the corporators are, in general, protected from unauthorized acts of their agents, yet at the same time, a rule of equal force requires that they should not deceive the public or lead them to trust and confide in the unauthorized acts of their agents. If they receive the avails and value of those acts, it is implicit evidence that they consented to and authorized them." A more particular discussion of the authorities on either side, would not be profitable. The general question is one which ought to be considered on principle; and I have so viewed it, because I find no settled rule which stands in the way of such an examination.

But little more need be said in reference to the particular case now before us. If the defendants did not become liable for the breach of their undertaking to carry the plaintiff, or of their duty resulting from that undertaking, I can see no ground for holding them accountable as simple wrongdoers. If their contract was *ultra vires*, and that defence to an action upon it must be received as absolute and peremptory,—if no principle of estoppel or rule of justice can be urged against that defence,—then it is more clear, that the simple wrong to the plaintiff's person was also *ultra vires*. It was with considerable difficulty that the liability of a corporation in any case for a pure tort was ever established; and they are never so liable, except when engaged in the performance of some duty or undertaking in respect to which accountability arises. If the defendants' express undertaking was absolutely void, so that no duty could arise thereupon, the implied undertaking, resulting from the actual attempt to carry the plaintiff as a passenger, is encountered by the same objection; and there is nothing left of the transaction, except a pure and simple tort, committed by the defendants' servants, while not engaged in any business which could bring responsibilities upon the defendants themselves. I think it plain, that this theory of liability will not sustain the plaintiff's case.

But I have no hesitation in affirming the judgment of the court below, upon the principles of contract, and of duty resulting therefrom. That the entire course of business in which the defendants were engaged could not be justified by their charters, I

am not prepared to deny. Each of them was chartered to build a railroad, the *termini* of which were specified; they built the roads, and then consolidated their business. The common interest might thus be promoted; but it is difficult to affirm, that the charter of either authorized its capital to be thus blended with that of the other; it is equally difficult to hold, that they had any rightful authority to construct or lease another road in continuation of the line. But these things were actually done, and they were done openly and publicly. If these acts were an abuse of power, the shareholders had ample opportunity to prevent or arrest the abuse; but no complaint from them has ever been heard, and their acquiescence must be presumed. If State sovereignties were wronged by the course of dealing pursued, no interference or complaint has come from that quarter. Conceding, then, that the defendants might change the attitude in which they stood toward the public and return at any time to the sphere of legitimate duty, they could not revoke past contracts, the consideration of which they had received, and upon the performance of which they had entered. They were bound to pay their servants and laborers, and they were liable for the careful transportation of freight committed to their charge. They could not invite a traveler into their cars, and, after injuring him by their negligence, reject the responsibilities of their contract. A traveller from New York to the Mississippi can hardly be required to furnish himself with the charters of all the railroads on his route, or to study a treatise on the law of corporations. The present case, in short, plainly falls within the principles of corporate liability herein asserted and the defendants must respond to that liability. The judgment should be affirmed.

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RABE V. DUNLAP.

NEW JERSEY COURT OF CHANCERY, 1893.

(25 Atl. Rep. 959.)

*Rights of Stockholders—Relief Against Ultra Vires Acts.—  
Laches.*

Van Fleet, V. C.: This is an application for an injunction. The application is resisted on the ground that the complainants have, by their laches, lost all right to either temporary or permanent relief; the contention being that they are not entitled



to an injunction now, nor can any relief be given to them on final hearing. The only question, however, before the court at this time, is whether or not an injunction should issue. The facts to be considered in deciding this question are almost entirely free from dispute.

The particular property which the complainants ask to have protected is shares of stock issued to them by the Lake Hopatcong Land & Improvement Company, a corporation organized under the laws of this state in August, 1885, with a capital of \$50,000, divided into 500 shares of \$100 each. Only 249 of the 500 shares appear to have been issued, and of these one of the complainants holds 5 shares, and the other 6. The principle purposes for which the corporation was organized were to buy and sell land, and erect buildings, on and about Lake Hopatcong. Some of the persons interested in this corporation, organized three others,—one on the 15th day of January, 1886, called the Lake Hopatcong Hotel Company the purposes of which were to buy and, and erect hotels, cottages and other appropriate structures thereon, and to carry on the business of an innkeeper; another on the 29th day of June, 1886, called the Lake Hopatcong Transportation & Steamboat Company, the purpose of which was to carry on the business of transporting passengers and merchandise for hire; and the third, on the 14th day of March, 1887, called the Hotel Breslin Villa Company, the purposes of which were to buy land, and erect hotels and other buildings thereon, and lease and sell the same. On the 17th day of April, 1888, a statute was passed, making it lawful for two or more corporations organized under the general laws of this state, and formed "for all or any of the following purposes: The improvement and sale of lands; the construction, maintenance and operation of hotels, and carrying on the business of an innkeeper; and the transportation of merchandise and passengers upon land and water,"—to consolidate and merge their corporate rights, franchises, powers, and privileges into a single corporation, so that all the property, rights, franchises, and privileges by law vested in the several corporations should, by the consolidation, be transferred to and vested in the corporation created by the consolidation. P. L. 1888, p. 441. This statute took effect immediately. It prescribes with particularity the "conditions and restrictions" to be performed and observed in consolidating two or more corporations. For the purposes of this discussion, it is unnecessary to state what these conditions and restrictions are, further than to say that no consolidation can be made until all of the corporations proposing to consolidate have entered into an agreement, under the corporate seals, prescribing the terms and conditions

of the consolidation, and the mode of carrying the same into effect, nor until the agreement so made has been submitted to the stockholders of each of the corporations separately, at a meeting called for that purpose, and has been sanctioned and approved by a majority of the shares present at such meeting.

Almost immediately after the enactment of this statute the four corporations just described consolidated under its authority. The corporation so created is called the Breslin Hotel & Land Company. The agreement to consolidate was made by the four corporations on the 4th day of May 1888, and was sanctioned and approved by their respective stockholders, in the manner prescribed by the statute, at a meeting held on the 31st day of the same month. Of the 249 shares issued by the corporation in which the complainants held stock, 184 were represented at the the meeting of the stockholders of that corporation, and voted in favor of consolidation. The complainants did not attend the meeting, nor was their stock represented there, though it is admitted that they had notice of the meeting, and its object, and also knew that a committee appointed by the four corporations to consider the expediency of amalgamation had made a report as early as February, 1888, in favor of consolidation. It is undisputed that the consolidation agreement conforms in all respects to the requirements of the statute, and also that every act which the statute requires to be done in order to make such an agreement valid and effectual was done in this case. The agreement, together with the sanction and approval of the stockholders, was filed in the office of the secretary of state on the 13th day of September, 1888. By force of the statute, such filing made the consolidation complete, and transformed the four distinct corporate entities into one. The property of the four corporations was thereupon conveyed to the new corporation, the Breslin Hotel & Land Company. The consolidation agreement provided that the stockholders of the corporation in which the complainants held stock should have the right to exchange their stock, share for share, for the preferred stock of the new corporation. Such preferred stock entitled its holder to a preferential dividend of six per cent. annually. The complainants were notified by a written notice that they had a right to exchange their stock for preferred stock of the new corporation, and also that a stockholders' meeting for the election of directors of the new corporation would be held in Hoboken on the 10th day of October, 1888. They paid no attention to the notice. The new corporation was on the day appointed organized, and proceeded at once to make contracts and incur obligations, and to carry on the various enterprises and ventures which the four corporations had previously con-

ducted separately. Between the 10th day of October, 1888, and the 21st day of October, 1889, the defendant Robert Dunlap loaned and advanced to the new corporation over \$22,000. He also, on the 25th day of November, 1889, indorsed for its accommodation a note for \$10,000, and another of the same amount on the 13th day of December, 1889, both of which he has since been compelled to pay. To secure Mr. Dunlap for what was due to him for moneys loaned and advanced, and also to protect him against the liability he had incurred in indorsing the two notes, the new corporation executed four mortgages to him on the 27th day of December, 1889,—two on its real estate and the other two on its chattles. Some of the land so conveyed in pledge is land which prior to the consolidation belonged to the corporation in which the complainants hold stock, and which after the consolidation was conveyed to the new corporation in performance of the consolidation agreement. On the date when these mortgages were executed it is not disputed that there was over \$24,000 due to Mr. Dunlap for loans and advances to the new corporation. Nor is it disputed that there is now a further sum of over \$18,000 due to him for money paid for the new corporation, in discharging the liability he incurred in indorsing the two notes. In March, 1892, a suit was brought in this court by Mr. Dunlap to foreclose his mortgages. No defense was made. A decree *pro confesso* has been entered, and a reference ordered; and the case, in respect to the matters referred, is now pending before the master. After the order of reference was made one of the complainants in this suit was allowed to intervene in that, with the right to make any defense which either of the defendants could have made.

It is at this point in the history of the new corporation that the complainants for the first time, ask for judicial protection of their rights; and the relief they now seek is of the most destructive kind to every right and interest standing opposed to their interests. They ask to have the new corporation ripped up from bottom to top, and that everything which it has done affecting their rights may be undone. Stated in detail, what they ask is this: That the new corporation may be declared to have been void from the beginning; that the deed by which the property of the corporation in which they are interested was conveyed to the new corporation may be declared to be a nullity, and that the property conveyed by it may be restored to the grantor, or to a trustee to be appointed for that purpose; that the new corporation may be required to account for all property of their corporation which it has disposed of; that the mortgages of the defendant may be decreed to be no lien on the land which their corporation conveyed to the new corporation, and that he may, in

addition, be commanded and required to execute a release, releasing such land from the operation of his mortgages; and that in the meantime, and as preliminary to the principal relief sought, the further prosecution of his foreclosure suit in this court may be stayed or restrained.

That the conveyance by the complainants' corporation of all of its property to the new corporation, for the purpose of appropriating it to new and different purposes from those for which the grantor corporation held it, was without power or right, and a plain misappropriation of the property, as against non-assenting stockholders, is a proposition that was not disputed on the argument. It cannot be. It is incontestable. The stockholders of a corporation have an indisputable right to have the property of the corporation applied and used exclusively for the purposes specified in its charter, and any attempt by its managers to appropriate it to any other purpose is a usurpation of power, and a violation of the rights of the stockholders. No rule of law is better settled than that which declares that a corporation created by statute, either special or general, can exercise no power, and has no rights, except such as are granted by express words or fair implication; and in the construction of such grants the rule is well settled that it must be held that what is fairly implied is as much granted as what is clearly expressed. By the charter of the complainants' corporation, its managers are given no power whatever to carry on the business of an inn-keeper or that of a common carrier, or to embark the property of the corporation in such or like enterprises. They are radically different from, and wholly foreign to, the purposes specified in its charter. The complainants were not deprived of their stock, or any of their rights, by the statute of 1888. It is beyond the power of the legislature to take away or destroy a vested right. Private property may be taken for public use on just compensation, but the use here was in no sense a public use. The only effect which can, in my judgment, be given to this statute in this case, is to hold that it made the new corporation a valid corporation as to those who should deal with it, and as against assenting stockholders, but it is left to the rights of the non-assenting stockholders in full vigor, and unimpaired. There can be no doubt, therefore, that had the complainants applied for an injunction promptly, and while it was in the power of the court to extend protection to them without doing wrong or injustice to others, it would have been granted. A corporation holds its property as the trustee of its stockholders, and they, like any other *cestui que trust*, have a right to have the trust property judiciously and honestly managed, and preserved from waste and misappropriation. But stockholders to be entitled to the

summary interference of the court in cases where they seek protection against acts which are merely in excess of the power of the corporation, and are not prohibited by law, must be diligent. They must apply so recently after the doing of the act of which they complain that the court may stop or undo the wrong to them without doing equal or greater wrong to some other person. The principal which must control the action of a court of equity in cases where the defense is laches was laid down by Lord Camden, many years ago in these words: "Nothing can call forth the activity of a court of equity but conscience, good faith and reasonable diligence. Where these are wanting the court is passive, and does nothing. Laches and neglect are always discountenanced, and therefore, from the beginning of this jurisdiction, there was always a limitation to suits in equity." *Smith v. Clay*, reported in a note to *Deloraine v. Browne*, 3 Brown, Ch. 639, 2 Amb. 645. This principle as it is applied to stockholders who are tardy in seeking protection against acts *ultra vires* of the corporation, was expressed by Sir John Romilly, master of the rolls, in *Gregory v. Patchett*, 33 Beav. 595, 602, in this form: "Shareholders cannot lie by, sanctioning, or by their silence at least acquiescing in an arrangement which is *ultra vires* of the company to which they belong, watching the result,—if it be favorable and profitable to themselves, to abide by it, and insist on its validity; but if it prove unfavorable and disastrous, then to institute proceedings to set it aside." And Lord Justice Turner's statement of the rule is equally pertinent to the case in hand. In *Great Western Ry. Co. v. Oxford, W. & W. Ry. Co.* 3 De Gex. M. & G. 341, 359, he said: "Where the summary interference of this court is invoked, in cases of this nature, it must be invoked promptly. Parties who have lain by and permitted a large expenditure to be made, in contravention of the rights for which they contend, cannot call upon the court for its summary interference. The jurisdiction to interfere is purely equitable, and it must be governed by equitable principles. One of the first of those principals is that parties coming into equity must do equity, and this principal more than reaches to cases of this description. If parties cannot come into equity without submitting to do equity a *fortiori* they cannot come for the summary interference of the court when their conduct before coming has been such as to prevent equity being done." The cases in which this principal as it is applied to stockholders, has been discussed, are numerous. The doctrine they establish is that where an act is done openly, and especially on notice, and without evil intent, though clearly in excess of the power of the corporation, a non-assenting stockholder will not be allowed to pause to speculate upon the chances, —to wait until he can see whether such act is likely to result

in profit or loss,—but, to be entitled to the summary interference of the court, he must ask for it promptly, and before the act of which he complains has become the foundation of rights or equities which must be destroyed, or greatly impaired, if the act be nullified or undone. Or, stated with greater brevity, and in its simple essence, the rule is this: If he wants protection against the consequences of an *ultra vires* act, he must ask for it with sufficient promptness to enable the court to do justice to him without doing injustice to others. *Kent v. Mining Co.*, 78 N. Y. 159; *Shelden Hat-Blocking Co. v. Eickemeyer Hat-Blocking Mach. Co.*, 90 N. Y. 607; *Watts' Appeal*, 78 Pa. St. 370; *Kitchen v. Railroad Co.*, 69 Mo. 224; *Taylor v. Railroad Co.*, 4 Woods, 575, 13 Fed. Rep. 152; *Graham v. Railroad Co.*, 2 Macn. & G. 146.

This principal must control the decision of the present application. No argument is required to show its pertinency. When the leading facts of the case are recalled, it applies itself. Whether the complainants remained inactive, to speculate upon the chances, intending to abide by the consolidation if it resulted in benefit, and, if not, to try to undo it, it is manifest that they acted precisely as they would have done if such had been their intention. Although they were fully informed of each step in the consolidation scheme, from its inception to its completion, and also of the fact that the new corporation had been organized, and was actively engaged in the prosecution of the several enterprises which had previously been carried on by the four corporations separately, yet for over three years they remained passive and inactive, and did nothing; and it is not until the new corporation has become insolvent, and all of its property is about to be sold to pay mortgages which were made and accepted while they were apparently assenting to the amalgamation, and all its consequences, that they seek to have the consolidation broken up, and the property of the corporation in which they are interested restored to it. They laid by until the new venture proved disastrous, and then, for the first time, they ask the court to undo what for over three years they had, by their inaction and delay, been apparently assenting to. Acquiescence or tacit assent, in such cases, was defined by Judge Folger in *Kent v. Mining Co.*, *supra*, to mean neglect to promptly and actively condemn the unauthorized act by suit. More than a year elapsed between the formation of the new corporation and the execution of the four mortgages to the defendant. If the validity of the new corporation had been promptly challenged by suit, it is almost absolutely certain that the debts secured by those mortgages would not have been contracted. Neither the mortgages or the debts would have then existed. As it is those mortgages are

unquestionably good and valid as against the assenting stockholders. It is probable that 237 out of the 249 shares have assented. It is certain that 184 have. In this situation of affairs it is obvious, to arrest the defendant's foreclosure suit will prevent him at least for the present, from enforcing that part of his security which is good beyond question; and this must be done, if done at all, to protect the complainants in the enjoyment of a right small in both extent and value, compared with that of the defendant, and which it is not at all certain they have not irretrievably lost by their laches. The complainants, in my judgement, occupy the position described by Lord Justice Turner when he said: "Suitors cannot come for the summary interference of the court when their conduct before coming has been such as to prevent equity being done." The complainants' application will be denied, with costs.

## CHAPTER VII.

## CAPITAL STOCK.

## SAWYER V. HOAG.

SUPREME COURT OF THE UNITED STATES, 1873.

(17 Wall. 601.)

*The Trust Fund Theory—Nature of Capital Stock.*

The Lumberman's Insurance Company of Chicago, was found to be insolvent after the disastrous fire of October, 1871, and in June, 1872, a petition was filed under which it was declared bankrupt, and the appellee appointed assignee. The appellant was a stockholder in the company to the extent of fifty shares of \$100 each. Among the effects of the company which came to the hands of the assignee was a note of appellant for \$4,250; and when payment was demanded of him, he produced and offered to set off against this demand the certificate of an adjusted loss given by the company to one Hayes for \$5,000, which had been assigned by Hayes to appellant. This certificate was given to Hayes and purchased by appellant at thirty-three per cent. of its par value on the same day, namely; January 25, 1872, after the insolvency of the company was well known, but before any proceedings in bankruptcy had been commenced. Upon the refusal of the assignee to consent to this set-off, the appellant filed the present bill in the district court to enforce the set-off in which he alleged, among other things, that the note given by him to the Insurance company was for money loaned.

The assignee in his answer denied that the note was for money loaned, and avered that it was in fact for a balance due by appellant for his stock subscription which had never been paid, and insisted that such balances constitute a trust fund for the benefit of all creditors of the insolvent corporation, which cannot be made the subject of a set-off against an ordinary debt due by the company to any one of its creditors. After the general replication, the case was submitted to the district court on an agreed statement of facts. The district court decreed against the complainant, from which he appealed to the circuit court, which affirmed the decree below, and from that decree it is brought by appeal to this court.



Mr. Justice Miller: The first and most important question to be decided is, whether the indebtedness of the appellant to the Insurance company is to be treated, for the purposes of this suit, as really based on a loan of money by the company to him, or as representing his unpaid stock subscription.

The charter under which the company was organized authorized it to commence business upon a capital stock of \$100,000, with \$10,000 paid in, and the remainder secured by notes with mortgages on real estate or otherwise. The transaction by which the appellant professes to have paid up his stock subscription is, shortly, this: he gave to the company his check for the full amount of his subscription, namely, \$5,000. He took the check of the company for \$4,250, being the amount of his subscription less the fifteen per cent. required of each stockholder to be paid in cash, and he gave his note for the amount of the latter check, with good collateral security for its payment, with interest at seven per cent. per annum. The appellant and the company, by its officers, agreed to call this latter transaction a loan, and the check of the appellant payment in full of his stock; and on the books of the company, and in all other respects as between themselves, it was treated as payment of the subscription and a loan of money. It is agreed that at this time the current rate of interest in Chicago was greater than seven per cent., and it is not stated as a fact whether these checks were ever presented and paid at any bank, or that any money was actually paid or received by either party in the transaction. It must, therefore, be treated as an agreement between the corporation, by its officers, on the one part, and the appellant, as a subscriber to the stock of the company, on the other part, to convert the debt which the latter owed to the company for his stock into a debt for the loan of money, thereby extinguishing the stock debt.

Undoubtedly this transaction, if nothing unfair was intended, was one which the parties could do effectually as far as they alone were concerned. Two private persons could thus change the nature of the indebtedness of one to the other if it was found to be mutually convenient to do so. And, in any controversy which might or could grow out of the matter between the insurance company and the appellant, we are not prepared to say that the company, as a corporate body, could deny that the stock was paid in full.

And on this consideration one of the main arguments on which the appellant seeks to reverse the decree stands. He assumes that the assignee in bankruptcy is the representative alone of the corporation, and can assert no right which it could not have asserted. The weakness of the argument is in this assumption. The assignee is the representative of the creditors as well

as the bankrupt. He is appointed by the creditors. The statute is full of authority to him to sue for and recover property, rights and credits, where the bankrupt could not have sustained the action, and to set aside as void, transactions by which the bankrupt himself would be bound. All this, of course, is in the interest of the creditors of the bankrupt.

Had the creditors of this insolvent corporation any right to look into and assail the transaction by which the appellant claims to have paid his stock subscription?

Though it be a doctrine of modern date, we think it now well established that the capital stock of a corporation, especially its unpaid subscriptions, is a trust fund for the benefit of the general creditors of the corporation. And when we consider the rapid development of corporations as instrumentalities of the commercial and business world in the last few years, with the corresponding necessities of adapting legal principles to the new and varying exigencies of this business, it is no solid objection to such a principle that it is modern, for the occasion for it could not sooner have arisen.

The principle is fully asserted in two recent cases in this court, namely: *Burke v. Smith* 16 Wall., 390, and in *New Albany v. Burke*, 11 Wall., 96. Both these cases turned upon the doctrine we have stated, and upon the necessary inference from that doctrine, that the governing officers of a corporation cannot, by agreement or other transaction with the stockholder, release the latter from his obligation to pay, to the prejudice of its creditors, except by fair and honest dealing and for a valuable consideration.

In the latter case, a judgment creditor of an insolvent railroad company having exhausted his remedy at law, sought to enforce this principle by a bill in chancery against the stockholders. The court by affirming the right of the corporation to deal with the debt due it for stock, as with any other debt, would have ended the case without further inquiry. But asserting, on the contrary, to its full extent, that such stock debts were trust funds in their hands for the benefit of the corporate creditors, and must in all cases be dealt with as trust funds are dealt with, it was found necessary to go into an elaborate inquiry to ascertain whether a violation of the trust had been committed. And though the court find that the transaction by which the stockholders had been released was a fair and valid one, as founded on the conditions of the original subscription, the assertion of the general rule on the subject is none the less authoritative and emphatic.

In the case before us the assignee of the bankrupt, in the interest of the creditors has a right to inquire into this conventional

payment of his stock by one of the shareholders of the company; and on that inquiry, we are of opinion that, as to these creditors, there was no valid payment of this stock by the appellant. We do not base this upon the ground that no money actually passed between the parties. It would have been just the same if, agreeing beforehand to turn the stock debt into a loan, the appellant had brought the money with him, paid it, taken a receipt for it, and carried it away with him. This would be precisely the equivalent of the exchange of checks between the parties. It is the intent and purpose of the transaction which forbids it to be treated as valid payment. It is the change of the character of the debt from one of a stock subscription unpaid to that of a loan of money. The debt ceases by this operation, if effectual, to be the trust fund to which creditors can look, and becomes ordinary assets, with which the directors may deal as they choose.

And this was precisely what was designed by the parties. It divested the claim against the stockholder of its character of a trust fund, and enabled both him and the directors to deal with it freed from that charge. There are three or four of these cases now before us in which precisely the same thing was done by other insurance companies organized in Chicago, and we have no doubt it was done by this company in regard to all their stockholders.

It was, therefore, a regular system of operations to the injury of the creditor, beneficial alone to the stockholder and the corporation.

We do not believe we characterize it too strongly when we say that it was a fraud upon the public who were expected to deal with them.

The result of it was that the capital stock of the company was neither paid up in actual money, nor did it exist in the form of deferred installments properly secured.

It is said by the appellant's counsel that, conceding this, it is still a debt due by him to the corporation at the time that he became the owner of the debt due by the corporation to Hayes and, therefore, the proper subject of set-off under the 20th section of the Bankrupt Act. That section is as follows: "In all cases of mutual debts or mutual credits between the parties, the account between them shall be stated, and one debt set off against the other, and the balance only shall be allowed or paid, but no set-off shall be allowed of a claim in its nature not provable against the estate: *Provided*, that no set-off shall be allowed in favor of any debtor to the bankrupt of a claim purchased by or transferred to him after the filing of the petition."

This section was not intended to enlarge the doctrine of set-

off, or to enable a party to make a set-off in cases where the principles of legal or equitable set-off did not previously authorize it.

The debts must be mutual; must be in the same right.

The case before us is not of that character. The debt which the appellant owed for his stock was a trust fund devoted to the payment of all the creditors of the company. As soon as the company became insolvent, and this fact became known to appellant, the right of set-off for an ordinary debt to its full amount ceased. It became a fund belonging equally in equity to all the creditors, and could not be appropriated by the debtor to the exclusive payment of his own claim.

It is unnecessary to go into the inquiry whether this claim was acquired before the commission of an act of bankruptcy by the company, or the effect of the bankruptcy proceeding. The result would be the same if the corporation was in the process of liquidation in the hands of a trustee or under other legal proceedings. It would still remain true that the unpaid stock was a trust fund for all the creditors, which could not be applied exclusively to the payment of one claim, though held by the stockholder who owed that amount on his subscription.

Nor do we think the relation of the appellant in this case to the corporation is without weight in the solution of the question before us. It is very true that, by the power of the legislature, there is created in all acts of incorporation a legal entity which can contract with its shareholders in the ordinary transactions of business as with other persons. It can buy of them, sell to them, make loans to them, and in insurance companies make contracts of insurance with them, in all of which both parties are bound by the ordinary laws of contract. The stockholder is also relieved from personal liability for the debts of the company. But after all, this artificial body is but the representative of its stockholders, and exists mainly for their benefit, and is governed and controlled by them through the officers whom they elect. And the interest and power of legal control of each shareholder is in exact proportion to the amount of his stock. It is, therefore, but just that when the interest of the public, or of strangers, dealing with this corporation is to be affected by any transaction between the stockholders who own the corporation and the corporation itself, such transaction should be subject to a rigid scrutiny, and if found to be infected with anything unfair toward such third person, calculated to injure him, or designed intentionally and inequitably to screen the stockholder from loss at the expense of the general creditor, it should be disregarded or annulled so far as it may inequitable affect him. *Affirmed.*

## HOSPES V. NORTHWESTERN MANUFACTURING &amp; CAR CO.

SUPREME COURT OF MINNESOTA, 1892.

(48 Minn. 174.)

*Bonus Stock—The Trust Fund Theory—Pleading.*

Mitchell, J.: This appeal is from an order overruling a demurrer to the so-called "supplemental complaint" of the Minnesota Thresher Manufacturing Company. The Northwestern Manufacturing & Car Company was a manufacturing corporation organized in May, 1882. Upon the complaint of a judgment creditor, (Hospes & Co.,) after return of execution unsatisfied, judgment was rendered in May, 1884, sequestrating all its property, things in action, and effects, and appointing a receiver of the same. This receivership still continues, the affairs of the corporation being not yet fully administered; but it appears that it is hopelessly insolvent, and that all the assets that have come into the hands of the receiver will not be sufficient to pay any considerable part of the debts. The Minnesota Thresher Manufacturing Company, a corporation organized in November, 1884, as creditor, became a party to the sequestration proceeding, and proved its claims against the insolvent corporation. In October, 1889, in behalf of itself and all other creditors who have exhibited their claims, it filed this complaint against certain stockholders (these appellants) of the car company in pursuance of an order of court allowing it to do so, and requiring those thus impleaded to appear and answer the complaint. The object is to recover from these stockholders the amount of certain stock held by them, but alleged never to have been paid for. What was said in Meagher's Case, 48 Minn. 158 is equally applicable here as to the right to enforce such a liability in the sequestration proceeding upon the petition or complaint of creditors who have become parties to it. There is nothing in this practice inconsistent with what was decided in Thresher Co. v. Langdon, 44 Minn. 37, 46 N. W. Rep. 310. The complaint is not the commencement of an independent action by creditors in their own behalf antagonistic to the rights of the receiver, but is filed in the sequestration proceeding itself, and in aid of it.

The principal question in the case is whether the complaint states facts showing that the thresher company, as creditor, is entitled to the relief prayed for; or in other words, states a cause

of action. Briefly stated, the allegations of the complaint are that on May 10, 1882, Seymour, Sabin & Co. owned property of the value of several million dollars, and a business then supposed to be profitable. That, in order to continue and enlarge this business, the parties interested in Seymour, Sabin & Co., with others, organized the car company, to which was sold the greater part of the assets of Seymour, Sabin & Co. at a valuation of \$2,267,000, in payment of which there were issued to Seymour, Sabin & Co. shares of the preferred stock of the car company of the par value of \$2,267,000, it being then and there agreed by both parties that this stock was in full payment of the property thus purchased. It is further alleged that the stockholders of Seymour, Sabin & Co., and the other persons who had agreed to become stockholders in the car company, were then desirous of issuing to themselves, and obtaining for their own benefit, a large amount of common stock of the car company, "without paying therefore, and without incurring any liability thereon or to pay therefor;" and for that purpose, and "in order to evade and set at naught the laws of this state," they caused Seymour, Sabin & Co. to subscribe for and agree to take common stock of the car company of the par value of \$1,500,000. That Seymour, Sabin & Co. thereupon subscribed for that amount of the common stock, but never paid therefor any consideration whatever, either in money or property. That thereafter these persons caused this stock to be issued to D. M. Sabin as trustee, to be by him distributed among them. That it was so distributed without receipt by him or the car company from any one of any consideration whatever, but was given by the car company and received by these parties entirely "gratiously." The car company was, at this time, free from debt, but afterwards became indebted to various persons for about \$3,000,000. The thrasher company, incorporated after the insolvency and receivership of the car company, for the purpose of securing possession of its assets, property, and business, and therewith engaging in and continuing the same kind of manufacturing, prior to October 27, 1887, purchased and became the owner of unsecured claims against the car company, "*bona fide*, and for a valuable consideration," to the aggregate amount of \$1,703,000. As creditor, standing on the purchase of these debts, which were contracted after the issue of this "bonus" stock, the thrasher company files this complaint to recover the par value of the stock as never having been paid for. The complaint does not allege what the consideration of these debts was, nor to whom originally owing, nor what the intervener paid for them, nor whether any of the original creditors trusted the car company on the faith of the bonus stock having been paid for. Neither does it allege that either the thrasher company or its assignors were ignorant

of the bonus issue of stock, nor that they or any of them were deceived or damaged in fact by such issue, nor that the bonus stock was of any value. Neither is there any traversable allegation of any actual fraud or intent to deceive or injure creditors. A desire to get something without paying for it, and actually getting it, is not fraudulent or unlawful if the donor consents, and no one else is injured by it; and the general allegation that it was done "in order to evade and set at naught the laws of the state" of itself amounts to nothing but a mere conclusion of law. As a creditors' bill, in the ordinary sense, the complaint is manifestly insufficient. The thrasher company, however, plants itself upon the so-called "trust fund" doctrine that the capital stock of a corporation is a trust fund for the payment of its debts; its contention being that such a "bonus" issue of stock creates, in case of the subsequent insolvency of the corporation, a liability on part of the stockholder in favor of creditors to pay for it, notwithstanding his contract with the corporation to the contrary.

This "trust fund" doctrine, commonly called the "American doctrine," has given rise to much confusion of ideas as to its real meaning, and much conflict of decision in its application. To such an extent has this been the case that many have questioned the accuracy of the phrase, as well as doubted the necessity or expediency of inventing any such doctrine. While a convenient phrase to express a certain general idea, it is not sufficiently precise or accurate to constitute a safe foundation upon which to build a system of legal rules. The doctrine was invented by Justice STORY in *Wood v. Dummer*, 3 Mason, 308, which called for no such invention, the fact in that case being that a bank divided up two-thirds of its capital among its stockholders without providing funds sufficient to pay its outstanding bill-holders. Upon old and familiar principles this was a fraud on creditors. Evidently all that the eminent jurist meant by the doctrine was that corporate property must be first appropriated to the payment of the debts of the company before there can be any distribution of it among stockholders,—a proposition that is sound upon the plainest principles of common honesty. In *Fogg v. Blair*, 133 U. S. 541, 10 Sup. Ct. Rep. 338, it is said that this is all the doctrine means. The expression used in *Wood v. Dummer* has, however, been taken up as a new discovery, which furnished a solution of every question on the subject. The phrase that "the capital of a corporation constitutes a trust fund for the benefit of creditors" is misleading. Corporate property is not held in trust, in any proper sense of the term. A trust implies two estates or interests,—one equitable and one legal; one person, as trustee, holding the legal title, while another, as the *cestui que trust*, has the beneficial interest. Absolute control and power of disposition are in-

consistent with the idea of a trust. The capital of a corporation is its property. It has the whole beneficial interest in it, as well as the legal title. It may use the income and profits of it, and sell and dispose of it, the same as a natural person. It is a trustee for its creditors in the same sense and to the same extent as a natural person, but no further. This is well illustrated and clearly announced in the case of *Graham v. La Crosse & M. R. Co.*, 102 U. S. 148. That was a creditors' suit to reach a piece of real estate on the ground that it had been conveyed by the corporation fraudulently for a wholly inadequate consideration. The trust-fund doctrine was invoked by a subsequent creditor, and it was claimed that, as the trust had been violated, the deed should be set aside. If the premise was correct that the corporation held it in trust for creditors, the conclusion was inevitable; but the court denied the premise, saying that a corporation is in law as distinct a being as an individual is, and is entitled to hold property (if not contrary to its charter) as absolutely as an individual can hold it. Its estate is the same, its interest is the same, its possession is the same; and that there is no reason why the disposal by a corporation of any of its property should be questioned by subsequent creditors any more than a like disposal by an individual; that the same principles of law apply to each. That the phrase that "the capital of a corporation is a trust fund for the payment of its creditors" is misleading, if not inaccurate, is illustrated by the character of the actions that are frequently mistakenly instituted on the strength of it. For example, in the case of *Wabash etc. R. Co. v. Ham*, 114 U. S. 587, 5 Sup. Ct. Rep. 1081, two roads had been consolidated, the new company acquiring the property of the old ones. A creditor of one of the old companies, on the strength of the "trust-fund" doctrine, claimed a lien on its property in the hands of the new corporation. If this property was impressed with a trust in favor of creditors in the hands of the old company, it would logically follow that it would continue so in the hands of the new one. But the court denied the relief, and, in giving its construction of the "trust-fund" doctrine, said: "The property of a corporation is doubtless a trust fund for the payment of its debts in the sense that when the corporation is lawfully dissolved, and all its business wound up, or when it is insolvent, all its creditors are entitled in equity to have their debts paid out of the corporate property before any distribution thereof among stockholders. It is also true, in the case of a corporation as in that of a natural person, that any conveyance of the property of the debtor without authority of law and in fraud of existing creditors is void." This is probably what is meant when it is said in some cases, as in *Clark v. Bever*, 139 U. S. 110, 11 Sup. Ct. Rep. 468, that the capital of a corporation is a trust fund *sub modo*.



If so, no one will dispute it. But it means very little, for the same thing could be truthfully said of the property of an individual or a partnership. And obviously it would make no difference whether the disposition of the corporate property is to a stranger or to a stockholder, except, that of course, the latter could not be an innocent purchaser.

There is also much confusion in regard to what the "trust-fund" doctrine applies. Some cases seem to hold that unpaid subscribed capital is a trust fund, while other assets are not,—that is, so long as the subscription is unpaid, it is held in trust by the corporation, but, when once paid in, it ceases to be a trust fund; while other cases hold that, paid or unpaid, it is all a trust fund. The first seems to be the rule laid down in *Sawyer v. Hoag*, 17 Wall. 610, in which the "trust-fund" doctrine was first squarely announced by that court with all the vigor and force characteristic of the great jurist who wrote the opinion. In that case a stockholder in an insurance company had given his note, as the court found the fact to be, for 85 per cent. of his subscription to the stock of the company. After the company had become bankrupt, and the stockholder knew the fact, he bought up a claim against the company for one-third its face, and in a suit by the assignee in bankruptcy on his note set up this claim as an offset. That this would have been a fraud on the bankrupt act, and at least a moral fraud on policy-holders, is quite apparent without invoking the "trust-fund" doctrine; and, if the note for unpaid stock was a trust fund, there could have been no offset, whether the company was solvent or insolvent. In the opinion it is said that, "if the subscription had been paid by the note or otherwise, the note ceased thereby to be a trust fund to which creditors can look, and becomes ordinary assets, with which directors may deal as they choose." But in *Upton v. Tribilcock*, 91 U. S. 45, it is stated: "The capital paid in and promised to be paid in is a fund which the trustees cannot squander or give away." While in *Sanger v. Upton*, Id. 56, it is said: "When debts are incurred a contract arises with the creditors that it [the capital] shall not be withdrawn or applied otherwise than upon their demands until such demands are satisfied." And in the same connection it is distinctly stated that there is no difference between assets paid in and subscriptions; that "unpaid stock is as much a part of this pledge and as much a part of the assets of the company as the cash which has been paid in upon it. Creditors have the same right to look to it as to anything else, and the same right to insist upon its payment as upon the payment of any other debt due to the company. As regards creditors, there is no distinction between such a demand and any other asset which may form a part of the property and effects of the corporation." This language is quoted and ap-

proved in *County of Morgan v. Allen*, 103 U. S. 498, 508. It would seem clear that this is the correct statement of the law. The capital (not the mere share certificates) means all the assets, however invested. If a subscriber gives his note for his stock, that note is no more and no less a trust fund than the money would have been if he had paid cash down. Capital cannot change from a trust to not a trust by a mere change of form. It is either all a trust or all not a trust, and the "trust-fund" rule, whatever that be, must apply to all alike, and in the same way. If the assets of a corporation are given back to stockholders, the result is the same as if the shares had been issued wholly or partly as a bonus. The latter is merely a short cut to the same result. So with dividends paid out of the capital, voluntary conveyances, stock paid in over-valued property; all are forms of one and the same thing, all reaching the same result, (a disposition of corporate assets,) which may or may not be a fraud on creditors, depending on circumstances. This much being once settled, the solution of the question when a subsequent creditor can insist on payment of stock issued as paid up, but not in fact paid for, or not paid for at par, becomes, as we shall presently see, comparatively simple.

Another proposition which we think must be sound is that creditors cannot recover on the ground of contract when the corporation could not. Their right to recover in such cases must rest on the ground that the acts of the stockholders with reference to the corporate capital constitutes a fraud on their rights. We have here a case where the contract between the corporation and the takers of the shares was specific that the shares should not be paid for. Therefore, unlike many of the cases cited, there is no ground for implying a promise to pay for them. The parties have explicitly agreed that there shall be no such implication by agreeing that the stock shall not be paid for. In such a case the creditors undoubtedly may have rights superior to the corporation, but these rights cannot rest on the implication that the shareholder agreed to do something directly contrary to his real agreement, but must be based on tort or fraud, actual or presumed. In England, since the act of 1867, there is an implied contract created by statute that "every share in any company shall be deemed and be taken to have been issued and to be held subject to the payment of the whole amount thereof in cash." This statutory contract makes every contrary contract void. Such a statute would be entirely just to all, for every one would be advised of its provisions, and could conduct himself accordingly. And in view of the fact that "watered" and "bonus" stock is one of the greatest abuses connected with the management of modern corporations, such a law might, on grounds of public policy, be very desirable. But this is a matter for the legislature, and not for the

courts. We have no such statute; and, even if the law of 1873, under which the car company was organized, impliedly forbids the issue of stock not paid for, the result might be that such issue would be void as *ultra vires*, and might be canceled, but such a prohibition would not of itself be sufficient to create an implied contract, contrary to the actual one, that the holder should pay for his stock.

It is well settled that an equity in favor of a creditor does not arise absolutely and in every case to have the holder of "bonus" stock pay for it contrary to his actual contract with the corporation. Thus no such equity exists in favor of one whose debt was contracted prior to the issue, since he could not have trusted the company upon the faith of such stock. *First Nat. Bank v. Gustin Min. Co.*, 42 Minn. 327, 44 N. W. Rep. 198; *Coit v. Amalgamating Co.*, 119 U. S. 347, 7 Sup. Ct. Rep. 231; *Handley v. Stutz*, 139 U. S. 435, 11 Sup. Ct. Rep. 530. It does not exist in favor of a subsequent creditor who has dealt with the corporation with full knowledge of the arrangement by which the "bonus" stock was issued, for a man cannot be defrauded by what which he knows when he acts. *First Nat. Bank v. Gustin etc. Min. Co.*, *supra*. It has also been held not to exist where stock has been issued and turned out at its full market value to pay corporate debts. *Clark v. Bever*, *supra*. The same has been held to be the case where an active corporation, whose original capital has been impaired, for the purpose of recuperating itself issues new stock, and sells it on the market for the best price obtainable, but for less than par, (*Handley v. Stutz*, *supra*;) although it is difficult to perceive, in the absence of a statute authorizing such a thing, (of which every one dealing with the corporations is bound to take notice,) any difference between the original stock of a new corporation and additional stock issued by a "going concern." It is difficult, if not impossible, to explain or reconcile these cases upon the "trust-fund" doctrine, or, in the light of them, to predicate the liability of the stockholder upon that doctrine. But by putting it upon the ground of fraud, and applying the old and familiar rules of law on that subject to the peculiar nature of a corporation and the relation which its stockholders bear to it and to the public, we have at once rational and logical ground on which to stand. The capital of a corporation is the basis of its credit. It is a substitute for the individual liability of those who own its stock. People deal with it and give it credit on the faith of it. They have a right to assume that it has paid in capital to the amount which it represents itself as having; and if they give it credit on the faith of that representation and if the representation is false, it is a fraud upon them; and, in case the corporation becomes insolvent, the law, upon the plainest principles of common justice, says to

the delinquent stockholder, "Make that representation good by paying for your stock." It certainly cannot require the invention of any new doctrine in order to enforce so familiar a rule of equity. It is the misrepresentation of fact in stating the amount of capital to be greater than it really is that is the true basis of the liability of the stockholder in such cases; and it follows that it is only those creditors who have relied, or who can fairly be presumed to have relied, upon the professed amount of capital, in whose favor the law will recognize and enforce an equity against the holders of "bonus" stock. This furnishes a rational and uniform rule, to which familiar principles are easily applied, and which frees the subject from many of the difficulties and apparent inconsistencies into which the "trust-fund" doctrine has involved it; and we think that, even when the trust-fund doctrine has been invoked, the decision in almost every well-considered case is readily referable to such a rule.

It is urged, however, that, if fraud be the basis of the stockholders' liability in such cases, the creditor should affirmatively allege that he believed that the bonus stock had been paid for, and represented so much actual capital, and that he gave credit to the incorporation on the faith of; and it is also argued that, while there may be a presumption to that effect in the case of a subsequent creditor, this is a mere presumption of fact, and that in pleadings no presumptions of fact are indulged in. This position is very plausible, and at first sight would seem to have much force; but we think it is unsound. Certainly any such rule of pleading or proof would work very inequitably in practice. Inasmuch as the capital of a corporation is the basis of its credit, its financial standing and reputation in the community has its source in, and is founded upon, the amount of its professed and supposed capital, and every one who deals with it does so upon the faith of that standing and reputation, although, as a matter of fact, he may have no personal knowledge of the amount of its professed capital, and in a majority of cases knows nothing about the shares of stock held by any particular stockholder, or, if so, what was paid for them. Hence, in a suit by such creditor against the holders of "bonus" stock, he could not truthfully allege, and could not affirmatively prove, that he believed that the defendants' stock had been paid for, and that he gave the corporation credit on the faith of it, although, as a matter of fact, he actually gave the credit on the faith of the financial standing of the corporation, which was based upon its apparent and professed amount of capital. The misrepresentation as to the amount of capital would operate as a fraud on such a creditor as fully and effectually as if he had personal knowledge of the existence of the defendants' stock, and be-

lieved it to have been paid for when he gave the credit. For this reason, among others, we think that all that it is necessary to allege or prove in that regard is that the plaintiff is a subsequent creditor; and that, if the fact was that he dealt with the corporation with knowledge of the arrangement by which the "bonus" stock was issued, this is a matter of defense. *Gogebic Inv. Co. v. Iron Chief Min. Co.*, 78 Wis. 427, 47 N. W. Rep. 726. Counsel cites *Fogg v. Blair*, *supra*, to the proposition that the complaint should have stated that this stock had some value; but that case is not in point, for the plaintiff there was a prior creditor; and, as his debt could not have been contracted on the faith of stock not then issued, he could only maintain his action, if at all, by alleging that the corporation parted with something of value.

In one respect, however, we think the complaint is clearly insufficient. The thrasher company is here asking the interposition of the court to aid in enforcing an equity in favor of creditors against the stockholders by declaring them liable to pay for this stock contrary to their actual contract with the corporation. While the proceeding is not, strictly speaking, an equitable action, yet the relief asked is equitable in its nature. Under such circumstances, it was incumbent upon the thrasher company to show its own equities, and that it was in a position to demand such relief. It was not the original creditor of the car company, but the assignee of the original creditors. By that purchase it, of course, succeeded to whatever strictly legal rights its assignors had; but it is not rights of that kind which it is here seeking to enforce. Under such circumstances, we think it was incumbent upon it to state what it paid for the claims, or at least to show that it paid a substantial, and not a mere nominal, consideration. The only allegation is that it paid "a valuable consideration." This might have been only one dollar. It appears that it bought the claims after the car company had become insolvent, and its affairs were in the hands of a receiver; also that the indebtedness of that company amounted to about \$3,000,000, and that there were not corporate assets enough to pay any considerable part of it. The mere chance of collecting something out of the stockholders does not ordinarily much enhance the selling price of claims against an insolvent corporation. If any person or company had gone to work and bought up for a mere song this large indebtedness of the car company for the purpose of speculating on the liability of the stockholders, no court would grant them the relief here prayed for. It would say to them, "We will not create and enforce an equity for the benefit of any such speculation." Counsel for respondent suggests that the thrasher company is but an organization of the original creditors, who formed it, and pooled their claims, so as to save some-

thing out of the wreck of the car company; but nothing of the kind is alleged. On this ground the demurrer should have been sustained.

In view of further proceedings it may be proper to say that in our opinion there is nothing in the position that the right of recovery against the stockholders was barred by the statute of limitation. The argument in support of the proposition all rests upon the false premise that the cause of action accrued in May, 1882, when the bonus stock was issued. The corporation never had any cause of action against these defendants. As between them and the company, the agreement for the issue of the stock was valid. The creditors are not here seeking to enforce a right of action, acquired through or from the corporation, but one that accrued directly to themselves, or for their benefit, and that did not accrue at least until the corporation became insolvent, in May, 1884.

Counsel for the St. Paul Trust Company stated that, if the court should reverse the order appealed from on any of the grounds urged by the other appellants, it would not be necessary for us to consider any of the assignments of error peculiar to his appeal; but, as we reverse upon a ground that may be remedied by amendment, we deem it proper to say that, in our opinion, the claim against the Kittson estate is a "contingent" claim, within the meaning of Gen. St. 1878, c. 53.

Order reversed.

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## KENT V. QUICKSILVER MINING CO.

NEW YORK COURT OF APPEALS, 1879.

(78 N. Y. 159.)

### *Preferred Stock—Ratification.*

Folger, J.: These are suits in equity to perpetually restrain the Quicksilver Mining Company from taking certain action, on the one hand proposed by it with the expressed assent of some only of the stockholders in it; and on the other hand, demanded of it by certain other of the stockholders in it, which demand it and still other stockholders resist.

Whatever the frame of the pleadings in the several actions, and whatever the formal prayer for judgment, the purpose of the litigation in each is to reach a final and binding judgment,

whether certain "*preferred stock*," heretofore created by that company, is so far valid as to be recognized in the future business of the company as giving to the holders thereof the peculiar right expressed in the certificate thereof.

What is meant by "*preferred stock*" is well enough known in law and business, without definition or circumlocution here.

All the powers which that company had were given to it by its charter, Laws of 1866, chap. 470, p. 1021; and by the Revised Statutes, vol. 1, pp. 599—600, §§ 1, 2, 3. Thereby it had the usual general powers of a corporation (see Angell & Ames on Corporations, §110). It had also the peculiar power of holding, improving and working mining lands in California and elsewhere, and of disposing of the product thereof. It had also the power to issue certificates of stock, representing the value of its property, in such form and subject to such regulations as it might from time to time by its by-laws prescribe, and to regulate and prescribe in what manner and form its contracts and obligations should be executed. It is claimed that it had also incidental and implied powers. So it had, so far as permitted by the Revised Statutes, which declare that in addition to the powers therein enumerated and to those expressly given in its charter, it should not possess nor exercise any, except such as should be necessary to the exercise of the powers so enumerated and given. 1 R. S., 600, § 3.

Plainly a mining corporation, for the exercise of its power of mining in its lands, must have money. Hence if it has it not, and cannot otherwise readily get it, it must, as necessary to the use of its corporate rights, have the power to borrow it; and in any way, and upon any obligation or security to be given by it, that is not unlawful. *Curtis v. Leavitt*, 15 N. Y., 9. It may borrow it from the stockholders in it, as well as from other parties; and it may determine and agree to borrow from them only. This corporation was in need of money to carry on its authorized business. It did get money, for that purpose and because of that need, from some of the stockholders in it, and in that instance from some of them alone. If the mode by which that money was got was a borrowing, within the sense which the law and common acceptance give to that term, then the transaction so far would have been lawful, and it would have remained to inquire whether the obligation given was a lawful instrument. But it was not a borrowing. The idea of a borrowing is not filled out unless there is in the agreement therefor a promise or understanding that what is borrowed will be repaid or returned; the thing itself or something like it of equal value, with or without compensation for the use of it in the meantime. To borrow is the reciprocal action with to lend, and to lend or to loan, say the diction-

aries, is the parting with a thing of value to another for a time fixed, or indefinite yet to have sometime an ending, to be used or enjoyed by that other, the thing itself, or the equivalent of it, to be given back at the time fixed, or when lawfully asked for, with or without compensation for the use as may be agreed upon. In this transaction with some stockholders that corporation had not the right, nor was it under the liability to ever pay back the five dollars per share furnished by them to it; that was not named in the terms of the obligation given, nor was it contemplated in the negotiation and bargain. The stockholder had not by the scope of his bargain, nor by the terms of the written evidence of it, any right ever to ask for repayment of the money furnished by him. In short, there was not formed thereby the relations of debtor and creditor. The stockholder parted forever with the money furnished, inasmuch as the charter of the company is perpetual, and the company made a perpetual charge upon its net earnings. Though there was a compensation fixed for the use of the money, and though it was to take the form of a yearly payment, and at a rate the same as the then lawful rate of interest, yet we cannot conceive that the transaction was a loan and borrowing of money, with a compensation for the use of it. If it had been, though the compensation was great for the sum furnished, yet it was not a violation of the usury laws of which the corporation could avail itself (Laws of 1850, chap. 172); and the courts might not overhaul it, save, perhaps, as an unconscionable and extortionate agreement (1 Story Eq. Juris., §§ 246-331), as to which we will speak again before the close. The transaction is not to be looked upon as other than a preference of one class of stockholders to another; as giving to the first class a perpetual inextinguishable prior right to a portion of the earnings of the company before the other class might have anything therefrom. It was none other than the creation of a "preferred stock."

Then there arises the query whether there was at that time power in the corporation to distinguish between the stockholders in it, to form them into two classes, and to give to one class rights in the corporate property, business and earnings from which the other was shut out.

We are not prepared to say that, at the first, the corporation might not have lawfully divided the interest in its capital stock into shares arranged in classes, preferring one class to another in the right it should have in the profits of the business. The charter gave power to make such by-laws as it might deem proper, consistent with constitution and law, and to issue certificates of stock representing the value of the property. We know nothing in the constitution or the law that inhibits a corporation from



beginning its corporate action by classifying the shares in its capital stock, with peculiar privileges to one share over another, and thus offering its stock to the public for subscriptions thereto. No rights are got until a subscription is made. Each subscriber would know for what class of stock he put down his name, and what right he got when he thus became a stockholder. There need be no deception or mistake; there would be no trenching upon rights previously acquired; no contract, express or implied, would be broken or impaired.

This corporation did otherwise. A by-law was duly made, which declared the whole value of its property and the whole amount of its capital stock, and divided the whole of it into shares equal in amount, and directed the issuing of certificates of stock therefor. It is not to be said that this by-law authorized anything but shares equal in value and in right, or that the taker of one did not own as large an interest in the corporation, its capital, affairs and profits to come, as any other holder of a share. Certificates of stock were issued under this by-law that gave no expression of anything different from that. When that by-law was adopted it was as much the law of the corporation as if its provisions had been a part of the charter. *Presbyterian Church v. City of New York*, 5 Cow., 538. So it is said in Grant on Corporations, page 80, in a qualified way. Thereby, and by the certificate, as between it and every stockholder, the capital stock of the company was fixed in amount, in the number of shares into which it was divisible, and in the peculiar and relative value of each share. The by-law entered into the compact between the corporation and every taker of a share; it was in the nature of a contract between them. The holding and owning of a share gave a right which could not be divested without the assent of the holder and owner, or unless the power so to do had been reserved in some way. *Mech. Bank v. N. Y. and N. H. R. R. Co.*, 13 N. Y., 599, 627. Shares of stock are in the nature of *choses in action*, and give the holder a fixed right in the division of the profits or earnings of a company so long as it exists, and of its effects when it is dissolved. That right is as inviolable as is any right in property, and can no more be taken away or lessened against the will of the owner than can any other right, unless power is reserved in the first instance, when it enters into the constitution of the right; or is properly derived afterwards from a superior law-giver. The certificate of stock is the muniment of the shareholder's title, and evidence of his right. It expresses the contract between the corporation and his co-stockholders and himself; and that contract cannot, he being unwilling, be taken away from him or changed as to him without his prior dereliction, or under the conditions above stated. Now, it is manifest that any action of a corpora-

tion which takes hold of the shares of its capital stock already sold and in the hands of lawful owners, and divides them into two classes—one of which is thereby given prior right to a receipt of a fixed sum from the earnings before the other may have any receipt therefrom, and is given an equal share afterwards with the other in what earnings may remain—destroys the equality of the shares, takes away a right which originally existed in it, and materially varies the effect of the certificate of stock.

It is said that when a corporation can lawfully buy property, or get money on loan, any known assurance may be exacted and given which does not fall within the prohibition, express or implied, of some statute *Curtis v. Leavitt*, 15 N. Y., 66—67; and that is sought to be applied here. But the prohibition to such action as this is found, not indeed in a statute commonly so called, but in the constitutional provision which forbids the impairment of vested rights, save for public purposes and on due compensation. The right which a stockholder gets on the purchase of his share and the issue to him of the certificate therefor is such a vested right.

It is contended that the power so to do is an incidental and implied power, necessary to the use of the other powers of the corporation, and is a legitimate means of raising money and securing the agreed consideration therefor. We have already conceded that it is legitimate to borrow money, and to secure the repayment of it, with a compensation for the use of it. But that is when it is done in such way as to put the burden upon every share of stock alike, and to enable every share of stock to be relieved therefrom alike; in such way as to preserve the equality of right and privilege and value of the shares, and maintain intact the contract thereto with the stockholder.

Citations are made to us for the converse of this, but they do not come up—sometimes in their facts, sometimes in their declarations—to the necessity of the proposition. Either it is where the capital is not limited and it is new shares that may be issued with a preference, and where there is express power to borrow on bond or mortgage 2 Redf. on Railways, chap. 33, sec. 4, § 237; *Harrison v. Mex. R. W.*, 12 Eng. Rep., 793; or the amount of the capital has not been reached and such stock is issued therefrom, *Hazelhurst v. Savannah R. R.*, 43 Ga., 53; *Tottan v. Tison*, 54 id., 139; or there was legislative authority, *Davis v. Proprietors*, 8 Metcf., 321; *Rutland R. R. Co. v. Thrall*, 35 Vt., 545; or a restriction to authorized capital and there was unanimous consent of the stockholders, *Prouty v. M. S. and N. I. R. R.*, 1 Hun, 663; 43 Ga., 53, *supra*; or there was power to redeem, which was a transaction in the nature of a debt, *Westchester, etc., R. R. Co. v. Jackson*, 77 Penn. St., 321; or the opinion was

*obiter*, *Bates v. Androscoggin R. R. Co.*, 49 Maine, 491; or it was the case of a subscription for stock with a condition for interest until the corporation was in operation, *Richardson v. Vt. and Mass. R. R. Co.*, 44 Vt., 613; or it was an action on a subscription more favorable to defendant than to other subscribers, and it was held that defendant could not set up the lack of equality, *Evansville R. R. Co. v. Evansville*, 15 Ind., 395; or a solemn determination of this question was not necessary for the disposal of the case, *Williston v. M. S. and N. I. R. R. Co.*, 13 Allen, 400; or the issue was authorized by the articles of association, *In re A'D. St. Nev. and Col. Co.*, 20 L. R. [Eq.], 339; or there was full knowledge on the part of all concerned, *Lockhart v. Van Alstyne*, 31 Mich., 81; or the power in the corporate body was conceded, and it was denied that it existed in the directors, *McLanghlin v. D. and M. R. R.*, 8 id., 100.

We will not say, for we are not called upon here to say, that never can a corporation rightfully, against the dissent of a portion of its stockholders, make some of the stock preferred; what we assert is that this case does not present a state of facts in which a power so to do exists.

There is a power in this charter to alter, amend, add to or repeal, at pleasure, by-laws before made. It is argued from this that it was in the power of the corporate body, in due form and manner, to alter the by-law which had fixed the amount of the capital stock and the number and relative value of the shares thereof. The power to make by-laws is to make such as are not inconsistent with the constitution and the law; and the power to alter has the same limit, so that no alteration could be made which would infringe a right already given and secured by the contract of the corporation. Nor was the power to alter, to the extent of affecting the contracted relative value of a share, reserved when the share was sold to the stockholder, so as to enter into and form a part of the contract. An alteration is a *pro tanto* repeal; but no private corporation can repeal a by-law so as to impair rights which have been given and become vested by virtue of the by-law afterwards repealed. All by-laws must be reasonable and consistent with the general principles of the laws of the land, which are to be determined by the courts, when a case is properly before them. *The Master, etc., v. Green*, 1 Ld. Raym., 113. A by-law may regulate or modify the constitution of a corporation, but cannot alter it. *Rex v. Cutbush*, 4 Burr., 2204; *R. W. Co. v. Allerton*, 18 Wall., 233. The alteration of a by-law is but the making of another upon the same matter. If the first must be reasonable and in accord with the principles of law, so must that which alters it. If then the power is reserved to alter, amend or repeal, and that reservation enters into a con-

tract, the power reserved is to pass reasonable by-laws, agreeable to law. But a by-law that will disturb a vested right is not such: see *Gray v. Portland Bank*, 3 Mass., 363; *Grant on Corps.*, 91. And it differs not when the power to make and alter by-laws is expressly given to a majority of the stockholders, and that the obnoxious ordinance is passed in due form.

It needs not that we consider the position that the issue of the preferred stock was an authorized increase of the capital, and so legal. It did not profess to be; nor was it in fact. For each share of preferred stock given out a share of common stock was taken in; so that the gross amount of the capital stock was still the same; and so were the number of shares and the nominal value of each share.

We are therefore of the opinion that there was no power in the corporate body, nor in a majority of the stockholders, to provide by by-law for the creation of a preferred stock, so as to bind a minority of the stockholders not assenting thereto.

It is claimed that though there was not that power, as the facts now appear, yet that there was general authority conferred by charter to create such a stock; and that the regularity of the issue of it created a presumption of validity upon which subsequent purchasers had a right to rely, and which, in the present position of parties, can not be questioned.

It is a rule that the dealings of a corporation, which on their face or according to their apparent import are within its powers, are not to be regarded as illegal and unauthorized, without some evidence tending to show that they are of that character. *Chauteauqua Bank v. Risley*, 19 N. Y., 369. It is another rule that acts done by a corporation, which presuppose the existence of other acts to make them legally operative, are presumptive proofs of the latter. *Nelson v. Eaton*, 26 N. Y., 410. And it may be that where a corporate act is within the general power of the corporation, and its invalidity arises from something not apparent in the grant of power to the body, and which is extrinsic thereto, that one dealing with the corporation in ignorance of that which vitiates will not be affected thereby. We need not rest there further than such principle is involved in the next topic which we consider. We have not definitely passed upon the question whether this corporation had power in the first instance to divide its stock into preferred and common, and that would need to be settled before disposing of the proposition just noticed.

But there remains a serious question: whether, though there was at the outstart a minority of the stockholders who gave no assent to the corporate act, there has not been such tacit acquiescence and delay in action by that minority as to amount to in-

defensible *laches* and estoppel upon those who constituted it and their assigns. In our judgment there has, and we find here a safe place on which to rest our decisions of these cases. The findings show that the by-laws empowering the creation and issue of the preferred stock were authorized at a stockholders' meeting regularly called and held and conducted; that the stock was at once offered for subscription to all of the stockholders; that a circular informing thereof was issued by authority and distributed to the stockholders; that, though all of them did not avail themselves of the chance to take it, it was not because the chance was not known; a large number of them did subscribe, and paid money for the privilege to the corporation, and that money went into the assets and business of the company; certificates for the preferred stock were thereupon issued, and it, as well as the common stock, was dealt in by the public, sales were made of the two kinds openly at the stock exchange, at prices for the one larger than for the other, and quoted in the daily public prints; and from year to year for four years the annual reports of the directors to the stockholders spoke of the two kinds of stock. There was ample knowledge, or means of knowledge, on the part of all stockholders, of the action of the corporation in the creation of the two kinds of stock, of the issue of certificates for the preferred stock, of the entry of that stock into the channels of trade, of the public dealings in it at the especial marts for the sale of such property, and of the continued recognition of its existence and validity by the company and the public. It is not to be conceived that the owners of the common stock of this corporation did not have actual knowledge that there had been created a stock having ostensibly greater right and value than their own, and that it had gone into the market and was dealt in by the public interested in the validity of it. For the lapse of four years, however, there was no action of the company, or of an individual stockholder, to have a judicial declaration that the company had exceeded its powers in the creation of the stock, and that it was invalid. We think that these facts, most of which are set forth in the findings in two of the cases, warrant the conclusion of law therein, that the stockholders, by acquiescing in the action of the corporation in making the preferred stock, have ratified and assented thereto, and that the same is binding on them by reason of such assent and ratification.

In the application of the doctrine of *ultra vires* it is to be borne in mind that it has two phases: one where the public is concerned; one where the question is between the corporate body and the stockholders in it, or between it and its stockholders, and third parties dealing with it and through it with them. When the public is concerned to restrain a corporation within the limit of the

power given to it by its charter, an assent by the stockholders to the use of unauthorized power by the corporate body will be of no avail. When it is a question of the right of a stockholder to restrain the corporate body within its express or incidental powers, the stockholder may in many cases be denied, on the ground of his express assent or his intelligent though tacit consent to the corporate action. If there be a departure from statutory direction, which is to be considered merely a breach of trust to be restrained by a stockholder, it is pertinent to consider what has been his conduct in regard thereto. A corporation may do acts which affect the public to its harm, inasmuch as they are *per se* illegal or are *malum prohibitum*. Then no assent of stockholders can validate them. It may do acts not thus illegal, though there is want of power to do them, which affect only the interest of the stockholders. They may be made good by the assent of the stockholders, so that strangers to the stockholders dealing in good faith with the corporation will be protected in a reliance upon those acts. The instance put in *Bissell v. Mich. So., ect., R. R. Co.* (22 N. Y., 269) is illustrative. A bank has no authority from the state to engage in benevolent enterprises; and a subscription, though formally made, for a charitable object would be out of its powers; but it would not be otherwise an illegal act; yet if every stockholder did expressly assent to such an application of the corporate funds, though it would still be in one sense *ultra vires*, no wrong would be done, no public interest harmed; and no stockholder could object, or claim that there was an infringement of his rights, and have redress or protection. Such an act, though beyond the power given by the charter, unless expressly prohibited, if confirmed by the stockholders could not be avoided by any of them to the harm of third persons. This arises from the principle that the trust for stockholders is not of a public nature. Per WILLES, J., *Taylor v. C. & M. R Co.*, 2 L. R. [Exch.,] 390. These questions have been so much discussed that we need not amplify. *Whitney Arms Co. v. Barlow*, 63 N. Y., 63; *Phosphate Co. v. Green*, L. R. [7 Com. Pl.], 43; *Evans v. Smallcombe*, L. R. [3 H. of L.], 249.

It was not expressly prohibited by the charter, or by any statute, to this corporation to classify the shares of its capital stock, so that one class should have greater right and value than another. It was not *malum in se* so to do, unless it was that a vested right was thereby affected; but that was not a public evil, it was a wrong that affected private persons only, and one which they might assent to. This case is thus, without the principle of *Ashbury Railroad Co. v. Riche*, 7 Eng. & I. App. [L. R.], 653, where the act was expressly prohibited. And where third parties have dealt with the company, relying in good faith upon the

existence of corporate authority to do an act, there it is not needed that there be an express assent thereto on the part of stockholders to work an equitable estoppel upon them. Their conduct may have been such, though negative in character, as to be taken for an acquiescence in the act; and when harm would come to such third parties if the act were held invalid, the stockholders are estopped from questioning it. We suppose acquiescence or tacit assent to mean the neglect to promptly and actively condemn the unauthorized act, and to seek judicial redress, after knowledge of the committal of it, whereby innocent third parties have been led to put themselves in a position from which they cannot be taken without loss. It is the doctrine of equitable estoppel, which applies to members of corporate or associated bodies, as well as to persons acting in a natural capacity: 2 Story Eq. Jur., § 1539. It is said that there is no question here between the stockholders and third parties; that it is a question between a minority of the stockholders and a majority of them or the assignees of that majority, and so all stockholders. True, it is a question at this time between the holders of preferred stock and of common stock; but it is a question of what were the rights which those preferred stockholders took on when they were strangers to the corporation and third parties as between it and the common stockholders in it. They were not stockholders, nor the assignees of stockholders, until as third parties they bought in the market shares of the preferred stock and parted with their money therefor. It was as third parties that they in good faith relied on that action of the corporate body; and so the question is between them as such and the common stockholders, whether they shall have that right in the corporation which they thought they were to get when they went into the market and bought the right of being a stockholder.

In our view of the matter, a holder of common stock had an equitable right to restrain the privileged payment to a preferred stockholder from the profits of the company, and to have the contract therefor declared invalid. It was his duty to have been prompt in his application to the courts for that relief, before evil could fall upon innocent parties; and where application to the courts therefor has been delayed by his neglect, and advantages have been gained by the corporate body, assistance should be denied: *Zabriskie v. Cleveland R. R. Co.*, 23 How. (U. S.), 395, 398; *Evans v. Smallcombe*, L. R., 3 H. of L. Cas. 249. It is said that the common stockholder should have some time in which to seek relief. It is enough to say in answer that four years at least went by before a holder of common stock asked for the aid of the courts, and then not until a holder of preferred stock

asked that aid to restrain proposed corporate action meant to put the common stock upon an equality with his own.

It is true that, as a rule, the assignee of corporate stock takes no greater right than his assignor had to give, and is subject to all the equities which burden the assignor. It may be that there are some holders of preferred stock who were the first holders thereof, and some who became at an early date owners of it by assignment from the first holders. As to those, there is some plausibility in the contention of the common stockholder that they may not, in a legal sense, be injuriously affected by his delay, though the court should order the preferred stock to be called in and canceled. But the prayer for judgment is that all of the preferred stock, in whose hands soever it may be, be so dealt with, or for action equivalent thereto. Many, probably most of the holders of it, have become so after it had been some time in the market, notoriously dealt in as a valid and recognized issue, and at prices greater than that at which the common stock ruled, and greater than would be restored to the holder by any mode of equalization now suggested. The difference in the market price of the two kinds of stock is here noticed only as being a notorious fact, which could not fail to meet the attention of holders of common stock, and to call upon them for prompt action, if they ever meant to question the validity of the preferred stock; and as showing that the equalization of the two kinds of stock, upon the basis of making good for the payment of five dollars per share, at which the preference was first subscribed for, would not restore many preferred holders to the position in which they once stood. It is not practicable to adjudge that one or some shares be called in and canceled, or equalized with the common stock, without all are so treated; and to treat all thus would be to do an injury to some persons who have acted in reliance upon the doings of the company, which have been until now unquestioned by the common stockholders.

Nor can the issue of the preferred stock, with the privilege attached to it, be said to be an executory contract. It is so only in a part of it which it remains for the corporation to do. The first holders of it made their subscriptions and paid the stipulated price; and so they executed the contract on their part, and the corporation and the common stockholder got the benefit of the execution. The stock has been issued and gone into the channels of trade. The price paid for the privilege held out by the offer of preferred stock went into the funds of the corporation, gave it relief from its needs, and aided in putting it upon a course of prosperity which enhanced the value in market not only of the preferred, but of the common stock. The contract has been executed in its essential parts; there remains to be done only what is a



consequence of it, the result of the purchase of the stock on the one side, and the sale of it on the other. That can scarcely be called a contract yet to be executed, in the application to it of the doctrine of *ultra vires*, whereby one party to it has received, and used for its purposes, the stipulated consideration, and has given to the other a right which he may sell in the market. The vendees cannot be put back to the situation in which they were when they bought, by any terms proposed by the corporation or the common stockholders. Both parties would not now have the same position as if no contract had been made: 63 N. Y., *supra*; *De Groff v. Am. Linen Thread Co.*, 21 N. Y., 127; 22 *id.*, *supra*.

We have before made mention of the position that the transaction was unconscionable and extortionate. Looking at it now, it seems to be so. In consideration of five dollars paid, the company undertook to repay seven dollars yearly for all time, if there should be enough earned to do so; which will be an enormous return. It is difficult to enter into the exact condition of things at the date of the transaction, and to estimate the propriety of such a bargain. It may be that the prospect of earnings at all, or enough to fulfil the undertaking, was too remote to be probable, and that it was a desperate chance that was taken by those who subscribed. There is some reason to suppose so, from the fact that the chance was offered to all stockholders, and that so many did not take it, though it now appears so preposterously advantageous. However that may be, an unconscionable arrangement will not be disturbed when there has been ratification of it with knowledge of all its bearings, after time has been had for consideration. 1 Story Eq. Jur., § 345.

## CHAPTER VIII.

## SUBSCRIPTION TO CAPITAL STOCK.

## JEFFERSON V. HEWETT.

SUPREME COURT OF CALIFORNIA, 1892.

(95 Cal. 535.)

*Subscription to Stock—Representations by Agent of the Corporation Concerning the Happening of a Future Event.*

Paterson, J.: On July 14, 1888, the defendants executed and delivered to the Santa Ana, Fairview & Pacific Railroad Company their non-negotiable note for the sum of \$5,000, payable four months after date, which was assigned to the Fair View Development Company, and by the last named company assigned to these appellants. The court found that the note was given for fifty shares of the capital stock of the company first above named, but that it was made and delivered "upon the sole consideration and inducement of the promise and assurance of said company that it would complete its railroad from Fair View to the Pacific ocean before the maturity of said promise in writing, to wit, within 60 or 90 days from said date; that the said company failed to complete its railroad, or any part thereof, \* \* \* within the said time, \* \* \* and that no part of said railroad between said last-named points has at any time been commenced and constructed or completed; that by reason of such failure the consideration of defendants' agreement to take said stock, and of their promise in writing set out in the complaint, has wholly failed;" but that the note "was not delivered upon the express condition that the railroad \* \* \* would be completed \* \* \* within sixty or ninety days from its date, nor upon condition that if said road was not so completed defendants would not have to pay said instrument or any part thereof. The court further found that the defendants notified the company of their failure to complete the road within the time specified, demanded the return of their note, and afterwards on answering herein brought the certificate of stock into court, and deposited it with the clerk for the plaintiffs. The defendant R. E. Hewitt testified that on July 10, 1888, Dr. Bailey stated to him that he was a stockholder, secretary, and director in the railroad company, and that there

was a limited amount of the capital stock not sold, "less than \$15,000 of the original \$60,000 issue, and that he was authorized to dispose of part of this to his friends;" that the company was going to increase the stock to \$200,000 or \$300,000, and place it on the market at once; "that the railroad was going right on from Fair View to the beach within sixty or ninety days at the furthest, and that he would take the stock if he could; that he held now a large amount of stock in the company;" that on the 13th the doctor came to his house, and said that "the engine and rolling stock of the company was paid for, but that the road was not doing much now more than paying expenses, but that it would be on a good paying basis as soon as it was extended to the beach, and that everything was ready to do this;" that on the 14th the doctor said he could rely implicitly upon his statements as a friend; that he would not make them unless they were true; and from his position in the company he knew that if defendants did not take the stock they would regret it; that the doctor insisted upon his taking 50 shares or more; that witness said to him he did not have the faith in this enterprise that the doctor had, and unless the road was completed to the beach he would not have the stock as a gift.

The findings of the court show that the statements of Dr. Bailey, testified to by the defendant, were made without any fraudulent purpose; that the defendants were prevented from making any investigation by reason of the statement of the doctor that he was the secretary and director of the company, and owned a large amount of stock therein, and from his position in the company he knew his statements were true, and that defendants could rely upon them; that the defendants believed the statements made by Bailey, and, relying upon them, were induced to make the note, and agree to take 50 shares of the capital stock of the company. We do not think that the facts shown by the record and found by the court constitute any defense to the action. The rule is well settled that statements concerning the happening of a future event cannot be relied upon to avoid subscriptions obtained by an agent of a corporation. Relating, as they do, to the probability or improbability of the happening of a future event, they must necessarily be matters of opinion merely. Morawetz states the proposition thus: "A statement made by an agent obtaining subscriptions for shares in a railroad company, to the effect that the proposed road would be built upon a certain route, or within a certain period of time, would not render a subscription made upon the faith of it voidable, though the statement be made with the intention to deceive, and the road be not built upon the route, or within the time, indicated." 1 Mor. Priv. Corp. § 98. And a large number of cases are cited in support of the text. See, also,

Thomp. Liab. Stockh. § 121. It is unnecessary for us to indorse the rule thus stated to its full extent, because, as we have seen, the court expressly found that the representations of Dr. Bailey were not fraudulent. The construction of the road to the ocean was no part of the consideration of the note; the findings negative the averment of the answer that the note was given "upon the express condition" that the railroad should be completed within 90 days. The matters relied upon, to be available as a defense, must be shown to have been a condition agreed upon by the parties. There is nothing in the cases cited by respondents inconsistent with the views we have expressed. The fair import of the testimony is that the representations referred to were the mere confident expression of opinion of one member of the board of directors that the road would be completed within 90 days, and that the defendants, placing confidence in that opinion, executed the note in suit.

The judgment and order are reversed, and the cause is remanded for a new trial.

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## CALIFORNIA SOUTHERN HOTEL CO. V. CALLENDER.

SUPREME COURT OF CALIFORNIA, 1892.

(94 Cal. 120.)

### *Subscription to Stock—Conditional Subscription—Waiver— Issuance of Certificate—Calls.*

Vanclief, C.: The plaintiff is a California corporation, to whose capital stock the defendant subscribed \$5,000 before its organization, that being 50 shares of the 1,000 shares into which the capital stock of \$100,000 was divided. After having paid \$2,000 of this subscription, the defendant refused to pay any part of the remainder, and this action was brought to recover from him the remaining \$3,000. The cause was tried by the court, and judgment was given in favor of the plaintiff for the sum demanded. The defendant appeals from the judgment on the judgment roll, without bill of exceptions, and contends that upon the findings of fact the judgment should have been given for the defendant. The following is a copy of the written agreement to and upon which defendant subscribed for the stock:

"We the undersigned, do hereby agree to and with each other that we will organize and form a corporation, under the laws of the state of California, for the purpose of erecting, building, and owning an hotel building in the city of San Luis Obispo, county of San Luis Obispo, state of California, and for the purpose of purchasing and owning all such real and personal property as may be necessary to be used in connection with said hotel building; and we agree that the capital stock of said corporation shall be one hundred thousand (\$100,000) dollars, divided into one thousand (1,000) shares, at the par value of one hundred dollars each; and we agree to and with each other that we do respectively subscribe for the number of shares of the stock of said corporation as are set after our respective names, and that we will pay for the same the said par value thereof at such times and in such manner as may be determined by the board of directors of the said corporation, to be hereafter chosen. And we further agree that whenever seventy thousand (\$70,000) dollars of said capital stock has been subscribed for, a meeting shall be called for the purpose of electing a board of directors, and taking such steps as are required by law to form the said corporation, and that at such meeting the owners of a majority of said subscribed stock shall constitute a quorum, and are authorized to elect said board of directors, and transact any business necessary to fully complete the organization of the said corporation. That the number of directors and the term of said corporation shall be determined at such meeting." Here follows the list of subscribers, among whom is the defendant for "fifty shares,—\$5,000." These subscriptions amounted to 772 shares. Among them was one of the Pacific Coast Steamship Company and Pacific Coast Railway Company for 100 shares, payable in freightage. This subscription purports to have been made through the agency of Goodall, Perkins & Co. Another of the subscriptions is by Edwin Goodall for 125 shares, partly payable in a block of land, if accepted by the company, estimated at \$7,500, and the balanced of \$5,000 in cash. The court finds that Goodall, Perkins & Co. were not authorized to subscribe for the steamship and railway companies, but that the subscriptions of these companies, and also that of Edwin Goodall, entered into the computation, and constituted a part of the 772 shares subscribed before the organization of the corporation. The court further found that the corporation was organized on August 17, 1887, and that the articles of incorporation included as subscribers the name of the Pacific Coast Steamship Company for 100 shares amounting to \$10,000, and that of Edwin Goodall for 125 shares amounting to \$12,500, without conditions; and further found "that at the preliminary meeting of stockholders, held for

the purpose of considering whether or not the incorporation aforesaid should be organized and formed, defendant was not present, and did not vote for the shares subscribed for by him as aforesaid, and did not acquiesce in or agree that the incorporation should be formed on the subscription aforesaid. \* \* \* That Edwin Goodall, for himself and for the Pacific Coast Steamship Company, united in the call for the meeting of the stockholders last aforesaid, and each were represented at said meeting to the full amount of the stock subscribed for by them as aforesaid by Edwin Goodall, and he voted and acted at said meeting for the full amount of the stock subscribed for by them, viz., 225 shares of the value of \$22,500; and each has ever since the incorporation of the plaintiff been, and now is, a stockholder in said corporation for the full value and amount of the stock aforesaid subscribed by him." And further that the subscriptions of the steamship company and Goodall were accepted and acted upon by plaintiff, and have been fully paid to the company. And further found that "defendant has at all times recognized the validity of the corporation aforesaid by paying \$2,000 of said original subscription of \$5,000, and not otherwise, and has never dissented from or protested against any of its acts. That defendant has, since said corporation was formed, acquiesced in the building of the hotel mentioned in said agreement, and furnishing the same, and the incurring of debts and expenditures of money therefor, by paying said \$2,000 of said subscription to said corporation, and not otherwise. \* \* \* That a large indebtedness has been incurred by plaintiff, and large sums of money expended, relying upon the subscriptions aforesaid." And further found (under the head of "conclusions of law") that the defendant "has waived any defense he might otherwise have had to said subscriptions by reason of the manner of plaintiff's incorporation." The findings show that calls were made upon the subscribers, including the defendant, as follows: November 16, 1887, 30 per cent., payable November 25th; March 17, 1888, 20 per cent., payable March 25th; May 23, 1888, 20 per cent., payable June 1st; 20 per cent., payable June 15th; and 20 per cent., payable July 1st.

1. The first and principal point made by appellant is that the corporation was organized before there was a valid subscription of \$70,000 of the capital stock, contrary to the agreement subscribed by defendant, inasmuch as Goodall, Perkins & Co. subscribed for the steamship company and railway company without authority, and, in part, conditionally. It appears however, that these subscriptions were changed before the corporation was organized, the railway company being dropped, and the subscription of the steamship company being substituted for that

of both of these companies, and for the full amount thereof, and the subscription of the steamship company and that of Goodall being made unconditional, and so entered in the articles of incorporation. It is also found by the court that Goodall, for himself and for the steamship company, united in the call for the meeting of the subscribers for the purpose of considering the propriety of organizing the corporation that Goodall represented all their stock at the meeting; that he signed and acknowledged the articles of incorporation; and that the steamship company and Goodall paid all the calls upon all the stock subscribed by them. It is not expressly found, nor, it seems to me, by necessary implication, that Goodall was not authorized by the steamship company to join in the call for the meeting, to make the change in the subscription, and to represent the steamship company in the organization of the corporation; but only that the original subscription by Goodall, Perkins & Co., for the two companies was without authority. If Goodall was authorized by the steamship company to represent it in all these matters, the corporation was properly organized, according to the subscription agreement, and the defendant has no ground of complaint. As, however, the findings are not quite clear upon this point, and as I think the judgment should be affirmed on another ground, which does not involve any doubtful question of construction of the findings, the decision of the case need not rest upon this point.

2. The court found that the defendant had "waived any defense he might otherwise have had to said subscription by reason of the manner of plaintiff's incorporation," Says Mr. Cook, in his book on Stock, Stockholders, and Corporation Law, (section 181;) "A subscriber may waive the defense that the full capital stock of the corporation has not been subscribed. This waiver may be either express or implied from the acts or declarations of the subscriber." Again, at section 186, the same author says: "Where the subscriber made his contract of subscription previous to, and in anticipation of the incorporation and does not, by his subsequent acts, acquiesce in the mode of incorporation, he may set up that the corporation has not been incorporated, and that he is not liable." At section 198 he says: "A subscriber to stock in a corporation may waive any defense he may have to the subscription. The waiver may be express, or it may be by implication from the acts and declarations of the subscriber. Thus a payment of a call with full knowledge of the defense, is held to be a waiver; and any act indicating a clear intent to abide by or accept or pass over an objection which the subscriber might make will be held to be a waiver." See authorities cited in notes to above quotation. Thompson, Liab. Stockh, § 120; Taylor,

Corp, § 519: and *Railroad Co. v. Johnson*, 64 Amer. Dec. 307. In *Fishback v. Van Dusen*, 33 Minn. 111, 22 N. W. Rep. 244, Mr. Justice MITCHELL, speaking for the court said: "Whether there has been a waiver is a question of fact. It may be proved by various species of evidence, by declarations, by acts, or by forbearance to act." Other authorities say it is a mixed question of law and fact, but that each case must depend upon its own peculiar circumstances and surroundings. "It is a question of intention, and a fact to be determined by the triers of fact," (*Okey v. Insurance Co.*, 29 Mo. App. 111; *Ehrlich v. Insurance Co.*, 88 Mo. 249; *Drake v. Insurance Co.*, 3 Grant, Cas. 325; *Witherell v. Insurance Co.*, 49 Me. 200;) "and, though the waiver must be intentional, and clearly proven, the sufficiency of the evidence relating thereto is for the jury." *Insurance Co. v. Schollenberger*, 44 Pa. St. 259. The only question of law that can be involved in the question of waiver must relate to the legal definition of the word. For example, a jury might be properly instructed as matter of law that a waiver must be voluntary, and that it implies a knowledge of the right, claim, or thing waived; yet whether it was voluntary, and whether the party had knowledge of the right or thing waived, are still questions of fact to be submitted to the jury. In this case the court found the ultimate fact that defendant had waived any right he may have had to object to the organization of the corporation. This finding implies the defendant's knowledge of the right waived and that this waiver was voluntary, since these attributes are included in the legal definition of a waiver. Nor is this conclusion affected by the fact that the court also found certain probative facts, the only tendency of which was to prove the waiver. That defendant recognized the validity of the corporation, and acquiesced in the building of the hotel, etc., "not otherwise" than by paying the first two calls on his subscription, and never dissenting or protesting against any of the acts of the corporation, are in no degree inconsistent with the waiver found, as they do not tend to prove that the waiver was involuntary, or without defendant's knowledge of his alleged right. Conceding, therefore, that the probative facts (unnecessarily) found are insufficient to prove a waiver, yet, as the record contains no part of the evidence it must be presumed that there was sufficient evidence to justify the finding of a waiver.

3. It is contended that this action cannot be maintained "on the theory that defendant is a stockholder, and, as such, liable to the corporation for assessments," for the alleged reason that it does not appear "that the corporation ever awarded any stock to defendant, or entered his name on its stock book, or anything to show that defendant was a stockholder." It is alleged in the



complaint, and expressly found by the court, that defendant was the owner of 50 shares of stock at all the times when the calls were made. It was not necessary to defendant's ownership of the stock that a certificate for the stock should have been issued to him, (*Mitchell v. Beckman*, 64 Cal. 121, 28 Pac. Rep. 110, and authorities there cited;) nor was the corporation bound to issue such certificate until the subscription price was fully paid; nor was it necessary to a recovery on the contract of subscription that the directors of the corporation should have levied assessments upon the stock in the mode prescribed by the Civil Code. By the contract of subscription the defendant agreed to pay upon the call of the board of directors, viz., "at such time and in such manner as may be determined by the board of directors of the said corporation, to be hereafter chosen;" and the action was properly brought upon this contract. *West v. Crawford*, 80 Cal. 27, 21 Pac. Rep. 1123. *Water Co. v. Herberger*, 82 Cal. 600, 23 Pac. Rep. 134; *Ang. & A. Corp.* § 549. I think the judgment should be affirmed.

We concur: FITZGERALD, C.; BELCHER, C.

*Per Curiam.* For the reasons given in the foregoing opinion the judgment is affirmed.

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## MINNEAPOLIS THRESHING MACHINE CO. V. DAVIS.

SUPREME COURT OF MINNESOTA, 1889.

(40 Minn. 110.)

### *Subscriptions—Secret Conditions.*

Mitchell, J.: This was an action to recover installments due on subscriptions to stock of the plaintiff. The facts fully appear from the findings of the court in connection with Exhibits A and B attached to the complaint. Those material for present purposes are, that a scheme having been started to organize a manufacturing corporation with \$250,000 capital, whose works should be located at Junction City, near Minneapolis, and one McDonald having proposed that if the citizens of Minneapolis would subscribe \$190,000 to the capital stock he would subscribe the remaining \$60,000, one Janney, a promoter, but not a subscriber to the stock of the proposed corporation, acting as a voluntary solicitor, having with him the subscription paper, (Exhibits A and B) about April 1, 1887, proceeded to canvass for

subscriptions to the stock of the proposed corporation on the terms and conditions embodied in the paper. He first applied to defendant, who subscribed \$5,000 of stock. Afterwards, and about the same date, other citizens respectively subscribed to the stock, on the same paper, to the aggregate amount, including defendant's subscription, of \$190,000, of which over \$65,000 has been paid in to plaintiff. Thereupon McDonald, in accordance with his proposition, subscribed the remaining \$60,000 which he has paid up in full. All the conditions expressed in the written subscription having been fully performed and complied with, the proposed corporation was afterwards, about April 25, 1887, organized, and these subscriptions to its stock delivered over to it. The corporation, acting in good faith upon such subscriptions, including that of defendant, expended large sums of money in locating and constructing its works, and entered into large contracts, and incurred liabilities to the amount of over \$75,000. During all this time, the corporation had no notice or knowledge of any condition being attached to defendant's subscription other than those expressed in the subscription paper itself. Neither is it found or claimed that any of the other subscribers to the stock had any such notice or knowledge. Defendant was not present at the organization of the corporation, and never attended or took part in any of its meetings, and had no notice or knowledge that the subscription paper had been transferred or delivered over to the plaintiff, or that plaintiff relied on it, until about November, 1887, just prior to the commencement of this action.

Upon the trial the defendant was permitted, against plaintiff's objection and exception, to testify that he signed or subscribed to the stock only upon the express oral condition and agreement then had between him and Janney that the latter should retain in his possession said agreement with his name signed thereto, and not deliver it to any one, or use it in any way, until certain four persons should subscribe to the stock, each in the sum of \$5,000; that Janney took the agreement from defendant on that express condition and understanding, and not otherwise; that none of these four persons ever did subscribe to the stock of the plaintiff; and that defendant never authorized Janney or any one to deliver said agreement to any one except upon the condition referred to. The court found the facts to be in accordance with the testimony, and upon that ground found as a conclusion of law that defendant never became a subscriber to the plaintiff's stock. The competency of this evidence is the sole question in this case. Under the elementary rule of evidence that a written agreement cannot be varied or added to by parol, it is not competent for a subscriber to stock to allege that he is but a conditional subscriber.

The condition must be inserted in the writing to be effectual. This rule applies with special force to a case like the present, where to allow the defendant now to set up a secret parol arrangement by which he may be released, while his fellow-subscribers continue to be bound, would be a fraud, not only upon them, but upon the corporation which has been organized on the faith of these subscriptions and upon its creditors. The defendant of course does not attempt to controvert so elementary a rule as the one suggested, but contends that the effect of this evidence was not to vary or contradict the terms of the writing, but to prove that there was never any delivery of it, and hence that there never was any contract at all, delivery being prerequisite to the very existence of a contract. His claim is that the subscription paper was given to and received by Janney merely as an escrow, or as in the nature of an escrow, only to be delivered or used upon the performance of certain conditions precedent, and that until they were performed there could be no valid delivery.

In determining this question it becomes important to consider the nature of a subscription to the stock of a proposed corporation, and the relation of the different parties to each other, under the facts of this case. A subscription by a number of persons to the stock of a corporation to be thereafter formed by them has in law a double character: *First*, It is a contract between the subscribers themselves to become stockholders without further act on their part immediately upon the formation of the corporation. As such a contract it is binding and irrevocable from the date of the subscription, (at least in the absence of fraud or mistake,) unless canceled by consent of all the subscribers before acceptance by the corporation. *Second*, It is also in the nature of a continuing offer to the proposed corporation, which, upon acceptance by it after its formation, becomes as to each subscriber a contract between him and the corporation. 1 Mor. Priv. Corp. § 47 et seq.; Red Wing Hotel Co. v. Frederick, 26 Minn. 112, 1 N. W. Rep. 827. Janney, the promoter who solicited and obtained the subscriptions, occupied the position of agent for the subscribers as a body, to hold the subscriptions until the corporation was formed in accordance with the terms and conditions expressed in the agreement, and then turn it over to the company without any further act of delivery on part of the subscribers. The corporation would then become the party to enforce the rights of the whole body of subscribers. It follows, then, that, considering the subscription as a contract between the subscribers, a delivery to Janney by a subscriber was a complete and valid delivery, so that his subscription became *eo instanti* a binding contract. The case stands precisely as a case where a contract is delivered by the obligor to the obligee. It cannot therefore be treated as a case

where a writing has been delivered to a third party in escrow. The defendant, however, attempts to bring the case within the rule of *Westman v. Crumweide*, 30 Minn. 313, 15 N. W. Rep. 255, in which this court held that parol evidence was admissible to show that a note delivered by the maker to the payee was not intended to be operative as a contract from its delivery, but only upon the happening of some contingency, though not expressed by its terms; that is, that the delivery was only in the nature of an escrow. We so held upon what seemed the great weight of authority, although the doctrine, even to the extent it was applied in that case, is a somewhat dangerous one. The distinction between proving by parol that the delivery of a contract was conditional, and that the contract itself contained a condition not expressed in the writing, is one founded more on refinement of logic than upon sound practical grounds. It endangers the salutary rule that written contracts shall not be varied by parol. Said *ERLE, J.*, in *Pym v. Campbell*, 6 El. & Bl. 370, in sustaining such a defense, "I grant the risk that such a defense may be set up without ground, and I agree that a jury should therefore look on such a defense with suspicion." And in all the cases where such a defense has been sustained, so far as we can discover, they have been cases strictly between the original parties, and where no one has changed his situation in reliance upon the contract and in ignorance of the secret oral condition attached to the delivery, and hence no question of equitable estoppel arose. Many of the cases have been careful to expressly limit the rule to such cases. *Benton v. Martin*, 52 N. Y. 570; *Sweet v. Stevens*, 7 R. I. 375.

Conceding the rule of *Westman v. Krumweide*, *supra*, to its full extent, there are certain well recognized doctrines of the law of equitable estoppel which render it inapplicable to the facts of the present case. This subscription agreement was not intended to be the sole contract of defendant. It was designed to be also signed by other parties, and from its very nature defendant must have known this. Each succeeding subscriber executed it more or less upon the faith of the subscriptions of others preceding his. The paper purports on its face to be a completed contract, containing all the terms and conditions which the subscribers intended it should. When this agreement was presented to others for subscription defendant had not only signed it in this form, but he had also done what, under the facts, constituted, to all outward appearances at least, a complete and valid delivery. He had placed it in the proper channel according to the ordinary and usual course of procedure for passing it over to the corporation when organized, and clothed Janney with all the *indicia* of authority to hold and use it for that purpose without any other

or further act on his part, untrameled by any condition other than those expressed in the writing. In reliance upon this, others have not only subscribed to the stock, but have since paid in a large share of it. The corporation has been organized and engaged in business, expending large sums of money, and contracting large liabilities, all upon the strength of these subscriptions to its stock, and in entire ignorance of this secret oral condition which defendant now claims to have attached to the delivery. To permit defendant to relieve himself from liability on any such ground under this state of facts, would be a fraud on others who have subscribed and paid for stock, upon the corporation, which has been organized and incurred liabilities in reliance upon the subscriptions, and on creditors who have trusted it. The familiar principle of equitable estoppel by conduct applies, viz: Where a person, by his words or conduct, wilfully causes another to believe in the existence of a certain state of facts, and induces him to act on that belief so as to alter his own previous condition, he is estopped from denying the truth of such facts to the prejudice of the other.

We have examined all of the numerous cases cited by defendant's counsel, and fail to find one which, in our judgment, is analogous in its facts, or the law of which will cover the present case. The two which at first sight might seem most strongly in his favor are *Beloit and Madison R. Co. v. Palmer*, 19 Wis. 574, and *Ottawa, ets. R. Co. v. Hall*, 1 Bradw. 612. But an examination of those cases will show that in neither did nor could any question of estoppel arise, and in both the court held that the person to whom the instrument was delivered after signature was a stranger to it, so that it was strictly a delivery in escrow to a third party. Cases are cited where a surety signed a bond or non-negotiable note, and delivered it to the principal obligor upon condition that it should not be delivered to the obligee until some other person signed it, and where, without such signature, the principal obligor delivered it to the obligee, and yet the courts held that the surety was not liable, although the obligee had no notice of the condition. Such cases seem usually to proceed upon the theory that a delivery to the principal obligor under such circumstances is a mere delivery in escrow to a stranger; the term "stranger," in the law of escrows, being used in opposition merely to the party to whom the contract runs. It may well be doubted whether in such cases where the instrument is complete on its face the courts have not sometimes ignored the law of equitable estoppel. No such defense would be allowed in the case of negotiable paper, and it is not clear why the distinction should be drawn on that line. The doctrine of estoppel rests upon totally different grounds, and operates independently of negotiability, being founded upon

principles of equity. But whether the cases referred to be right or wrong, we do not see that they are in point here. Our conclusion is that the court erred in admitting the evidence objected to, and for that reason a new trial must be awarded. Order reversed.

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MARSON V. DEITHER.

SUPREME COURT OF MINNESOTA, 1892.

(49 Minn. 422.)

*Calls Upon Stock of an Insolvent Company—Tender of Certificate of Stock.*

Mitchell J.: This was an action by the assignee of an insolvent corporation on a subscription for stock of the company. According to the complaint, the defendant had subscribed for a certain number of shares of the stock, payable in "such manner and at such times as the board of directors of the company might direct." The corporation had made an assignment for the benefit of its creditors under the general insolvency law, and the plaintiff had been appointed and had qualified as assignee. The court in which the insolvency proceedings were pending had made an order requiring the stockholders, including this defendant, to pay forty per cent. of the amount of stock subscribed for by them. Notwithstanding due and seasonable notice of this order, and a demand by plaintiff for payment, the defendant had neglected and refused to pay the same. We are unable to see why this does not state a cause of action. Some of counsel's criticisms on the complaint proceed upon the assumption that the action is brought on the order of court, and that defendant's liability is based upon that alone. This is clearly erroneous. The cause of action alleged is founded on the subscription contract. Of course, the money did not become due or payable until a call had been made by the directors, or some authorized demand for payment made equivalent to such a call. But this is but a step in the process of collection, and the order of court, which was equivalent to a "call," was pleaded, not as the basis of defendant's liability, but to show that the money had become due and payable according to the terms of the contract. The authority and jurisdiction of the court in which the insolvency

proceedings were pending to make an order requiring payment of unpaid stock subscriptions, as the directors might have done before the insolvency proceedings, is so well established as hardly to require the citation of authorities. The court will, in such cases, do, in behalf of creditors, what it is the duty of the corporation to do in respect to calls, and may itself make the call, although by the terms of the contract of subscription the money is payable on the call of the directors. *Sanger v. Upton*, 91 U. S. 56; *Hatch v. Dana*, 101 U. S. 215; *Scovill v. Thayer*, 105 U. S. 155; *Cook*, Stocks § 207. It is urged that the complaint is defective in not alleging the issue and tender of a certificate for the stock. This "call" is only for forty percent., and it does not appear that the other sixty percent. had been paid. As a party is not entitled to a certificate until the stock is fully paid, the point, so far as the present appeal is concerned, might be disposed of by this statement of the facts. But there is a doubt, under our decisions, as to the precise position of this court upon the question as to whether it is any defense to an action on a stock subscription that no certificate has been issued and tendered, which had better be removed at this time. In *St. Paul, S. & T. F. Co. v. Robbins*, 23 Minn. 439, (where the issue was of preferred stock, after the whole of the original stock had been issued,) it was held that a tender of a certificate was necessary and should be pleaded. This case seems to put the subscription for the stock on the footing of a contract for the purchase of property, where the promise to sell and the promise to pay are concurrent and dependent, and where consequently neither party can compel the other to perform without performing or offering to perform on his part. If the so-called "preferred stock" in that case was, as is often the fact, the obligations of the corporation, or merely pledges of its revenues, of course it stood on the same footing as any other purchase. But that the decision was understood as applying to subscriptions for stock, properly so called, is evident from what is said in *Minneapolis Harvester Works v. Libby*, 24 Minn. 327. Without having our attention called to these cases, and not having them in mind, we held in *Columbia Electric Co. v. Dixon*, 46 Minn. 463, 49 N. W. Rep. 244, that it is no defense to an action on a stock subscription to allege that no certificate for the stock has been tendered. It would *a fortiori* follow that it was not necessary to allege a tender in the complaint. This is the rule generally, if not universally laid down in the textbooks, and is supported by an almost unbroken line of decisions. The ground upon which it is put is that a subscription for the stock of a corporation does not stand on the footing of a purchase of property; that when the subscriber pays, he is the owner of the stock; that it is the payment which makes him a stockholder, the certificate being merely the evidence of

his right; that he is a full stockholder, with all the rights of one, even if a certificate is never issued to him; and therefore it is for him to demand the certificate when he wishes one, and not for the corporation to tender one. This doctrine being, as it seems, in accordance with the general current of the authorities, we shall follow it, and adhere to the decision in *Columbia Electric Co. v. Dixon*, supra. And, so far as this question is concerned, we can see no distinction between a subscription to the stock of a corporation already fully organized and a subscription made prior to and for the purposes of organization. The rule, of course, has no application to the case of a sale of stock, which stands on the same footing as any other contract of purchase of property. It is also undoubtedly true that parties may contract that the stock shall not be paid for until the certificate therefor has been issued and delivered or tendered. Compare *Summers v. Sleeth*, 45 Ind. 598 with *Miller v. Wild-Cat Gravel Road Co.*, 52 Ind. 51. Order affirmed.



## CHAPTER IX

## MEMBERSHIP.

## HOOD V. MCNAUGHTON.\*

NEW JERSEY SUPREME COURT, 1892.

(54 N. J. L. 425.)

*Liability of Subscribers for Stock—Discharge by Transfer—  
Action to Recover Balance Unpaid on Stock Subscription.*

Van Syckel, J.: The defendant was an original subscriber to the capital stock of the Fidelity Trust & Safe Deposit Company, for 10 shares of the par value of \$100 each, on which only 10 per cent. of the subscription price has been paid. The by-laws of the said company provide that "transfers of stock shall be made only on the books of the company. That no transfer shall be made until the certificate granted to the transferrer is delivered up to the company; and the possession of a certificate of stock shall not be regarded as vesting any ownership in the same in any other than the person in whose name it is issued, as between the company and such owner, until the transfer be duly made on the books of the company as aforesaid." On the 28th day of February, 1890, and after the defendant had paid 10 per cent. on the said shares subscribed for by him, he sold the said shares, and delivered his certificate therefor to the vendee, but the shares were not transferred on the books of the company, as required by the by-laws. The said company subsequently became insolvent, and, upon proceedings duly taken in the court of chancery of this state, John Hood, the plaintiff, was appointed receiver thereof. The receiver filed his petition in the court of chancery, giving the names of the subscribers to the stock, and the amount still due to the company upon the shares subscribed for, and thereupon the chancellor, on the 27th day of October, 1890, ordered and decreed that the said subscribers be severally required to pay to the receiver the full amount due to the company for their stock, and the said receiver was authorized and directed to collect the same by suit if necessary. The defendant having refused to pay upon

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\*Young v. McKay, 50 Fed. Rep., 394. Plumb v. Bank of Enterprise (Kan.) 29 Pac. Rep. 699

demand made by the receiver, this suit was instituted, and under the direction of the trial court a verdict was rendered for the plaintiff for the amount claimed by him.

Section 5 of our corporation act (Rev., p. 178) provides that, where the whole capital of a corporation shall not have been paid in, and the capital paid shall be insufficient to satisfy the claims of its creditors, each stockholder shall be bound to pay on each share held by him the sum necessary to complete such share, or such proportion of that sum as shall be required to satisfy the debts of the company. Section 70 of the same act prescribes how proceedings shall be taken to declare corporations insolvent; and section 77 provides that the receiver, when appointed, shall be a trustee for the creditors and stockholders of the company, with full power to institute suits at law or in equity to recover the assets thereof. These provisions are declaratory of the common law. By the common law the stockholders of an incorporated company are liable to pay their subscriptions, if such payment be necessary to discharge the debts of the company. A court of equity has power to compel such payment. The capital stock which has been paid in and which remains unpaid is regarded as a trust fund pledged for the payment of the debts of the corporation. *Spear v. Grant*, 16 Mass. 9; *Nathan v. Whitlock*, 9 Paige, 152; *Ward v. Griswoldville Co.*, 16 Conn. 593; *Adler v. Milwaukee Co.*, 13 Wis. 57.

The insistence that it was unnecessary, and therefore illegal, to require the defendant to pay the full amount unpaid on his shares in order to satisfy the debts of the company, cannot be entertained in this court. The decree of the court of chancery requires the payment of the entire amount, and the validity of that decree cannot be drawn in question in this suit, which is collateral to it. The receiver stands in the place of the stockholders as their representative, and all the rights of the company reside in him. The company, before insolvency, could have called the whole amount unpaid, and such a call could not, in the absence of fraud, have been questioned by the stockholders. If there remains a surplus in the hands of the receiver after the debts are paid, he will distribute it to the shareholders equitably. The real question in the case is whether the defendant had assigned his shares in such a way as to relieve him of responsibility. In *Marlborough Co. v. Smith*, 2 Conn. 579, the incorporating act provided that the stock of the company should be transferable only on the books of the company, and it was held that such mode of transfer was necessary to absolve the subscriber from the payment of an assessment on his stock. In the subsequent case of *Oxford Turnpike Co. v. Bunnell*, 6 Conn. 552, the same rule as to the validity of the transfer of shares was

applied, where the by-laws, and not the charter, prescribed that the transfer should be made upon the books of the company. In *Dane v. Young*, 61 Me. 160, the transfer not having been made in accordance with the requirement of the by-laws, the original subscriber was charged with liability for the debts of the company. In Pennsylvania the capital stock of a corporation is regarded as a trust fund for the protection and benefit of creditors, and a subscriber cannot cast off his liability for corporate debts by the transfer of his stock to another. *Messersmith v. Bank*, 96 Pa. St. 440. A distinction is drawn between one who holds his stock by transfer and an original subscriber. The former may, in the absence of any fraudulent purpose, discharge himself from liability for unpaid installments by due transfer of his shares; while the latter cannot obtain immunity in that way. The cases of *West Phila. Co. v. Innes*, 3 Whart. 197, and *Pittsburgh Co. v. Clarke*, 29 Pa. St. 146, show that the decisions in that state are somewhat controlled by the provisions of the acts of incorporation. Upon principal it seems that the result must be the same without regard to charter provisions. The subscription to the stock and the acceptance of a certificate for the shares constitute a contract between the subscriber and the company, by which the subscriber engages to pay the remaining installment on demand of the corporation. From this agreement the subscriber cannot recede without the assent of the company. He may transfer his stock without consent of the company, and thereby vest in the purchaser his right to the shares, and, as between himself and such purchaser, cast upon the latter the obligation to pay him such installments as are called upon the stock; but the subscriber cannot thereby impair or affect the contract rights of the company. His liability to the company cannot thereby become extinguished. In *Burke v. Smith*, 16 Wall. 395, Mr. Justice STRONG, recognizes the rule that the mere assignment of his shares by a subscriber does not relieve him from liability until the assignee is accepted as a share holder by the company, and substituted in his place. The New York statute provides that "no transfer of stock shall be valid for any purpose whatever except to render the person to whom it shall be transferred liable for the debts of the company according to the provisions of said act, until it shall have been entered in the corporate stock book by an entry showing to and by whom transferred." In *Shellington v. Howland*, 53 N. Y. 371, the New York court of appeals declared that a transfer of stock, valid as between parties, but not consummated in the form required by said statute, by entry on the book of registry of stockholders, did not divest the transferrer of liability as a stockholder to the creditors of the corporation. In this state a transfer of shares

in an incorporated company, not made in accordance with the requirements of its charter, has been held to be valid so far as to pass the transferrer's title to the stock to his vendee; but in this case the stock was full paid, and the rights of the company or its creditors as against the transferrer were in no wise involved. *Bank v. McElarth*, 13 N. J. Eq. 24. In case before us no circumstance is present to show that the company consented to an abrogation of its contract with the defendant, or to the substitution of his vendee as a shareholder. If the subscriber could, without the consent of the company, divest himself of his shares and of his entire obligation as a stockholder, corporations might in all cases be deprived of their only available means of satisfying debts by transfer to irresponsible parties. A verdict in favor of the receiver was properly ordered, and the rule to show cause should be discharged.

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GILCHRIST V. HELENA, HOT SPRINGS & SMELTER  
R. CO.\*

U. S. C. C. D. MONT., 1892.

(49 Fed. Rep. 519.)

*Stockholders' Liability—Set-off of Judgment.*

Knowles, J.: Plaintiffs obtained two judgments against the defendant Helena, Hot Springs & Smelter Railroad Company, a corporation organized under the laws of Montana. These judgments, it is claimed, were liens upon the property of said railroad company by virtue of the provisions of section 707, Comp. St. Mont. p. 824. Plaintiffs then brought an action in equity to have their said liens satisfied out of the said property, and to be declared a prior lien to that of the Farmers' Loan & Trust Company, which they made a party to the action. Many other parties who have judgments against said railroad company, claimed to be liens on the property of the same, were made parties. It was prayed, among other things, that a receiver be appointed, etc. The Northwestern Guaranty Loan Company, a corporation organized under the laws of Minnesota, and Erastus D. Edgerton, asked to be allowed to intervene in said action. This petition was granted. The cause was removed from the

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\* See *Appleton v. Turnbull* (Me.), 24 Atl. Rep. 592 (1891).

state court to this. The Northwestern Guaranty Loan Company filed its bill of intervention, setting forth that the Helena, Hot Springs & Smelter Railroad Company made, executed, and delivered to the Farmers' Loan & Trust Company, as a trustee, a mortgage upon its property to secure the payment of some 150 bonds, of \$1,000 each, of said railroad company; that 100 of said bonds, amounting to \$100,000, were sold to said intervener, who is now the owner and holder thereof; that said railroad company has failed to pay said bonds, or the interest thereon, according to their terms, and in accordance with the terms of said mortgage; that the said trustee, the Farmers' Loan & Trust Company, has failed to enforce the rights of the said intervener in the premises, although requested by it in writing, and the proper security for costs and expenses offered, as is required in the mortgage deed aforesaid. Intervener asks to have the said mortgage foreclosed, and the property sold to satisfy said bonds. The bill, also, among other things, sets forth that, in organization of the said railroad company, W. E. Cullen, H. B. Palmer, C. G. Evans, and W. H. Hunt subscribed each, to the capital stock of said company, the sum of \$33,750, and one R. C. Wallace the sum of \$15,000; that the stock subscribed by the said Hunt was for the use and benefit of one William Muth, who is now the owner and holder thereof, to-wit, 337½ shares of said stock; that no payment has been made on said stock subscription. The bill further shows that certain judgments against said railroad company held by W. C. Whipps and W. E. Cox and George Green were purchased by them from the parties who obtained them, for William Muth, who is now, in fact, the owner of the same, and claims them as a lien upon the property embraced in the mortgage. These claims amount to near \$3,000. It is alleged that the said railroad company is insolvent. The bill asks that these claims be canceled or offset by an equal sum of the amount due by said Muth on his unpaid stock subscription. The said Muth demurred to this portion of said bill of intervention, and the question is presented as to whether the said unpaid stock subscription should be reduced by the amount of said judgments; that is, so much thereof be offset against said judgments.

The money which the said Muth owes said railroad company for unpaid stock subscription is a trust fund, which should be paid into the treasury of the company for the benefit of all the creditors. The debts which the company owes to said Muth on these judgments is not of this character. In the case of *Sawyer v. Hoag*, 17 Wall. 610, the supreme court said, in a case in which the plaintiff, Sawyer, sought to compel the defendant, Hoag, as an assignee in bankruptcy of an insolvent insurance company, to allow, as a set-off, a certain claim which he held against the in-

insurance company on the amount due from him on a subscription of stock to said company:

"The debts must be mutual—must be in the same right. The case before us is not of that character. The debt which the appellant owed for his stock was a trust fund, devoted to the payment of all the creditors of the company. As soon as the company became insolvent, and this fact became known to the appellant, the right of set-off for an ordinary debt to its full amount ceased. It became a fund belonging equally in equity to all the creditors, and could not be appropriated by the debtor to the exclusive payment of his own claim. It is unnecessary to go into the inquiry whether this claim was acquired before the commission of an act of bankruptcy by the company, or the effect of the bankruptcy proceedings. The result would be the same if the corporation was in the process of liquidation in the hands of a trustee, or under other legal proceedings. It would still remain true that the unpaid stock was a trust fund for all the creditors, which could not be applied exclusively to the payment of one claim, though held by a stockholder who owed that amount on his subscription."

This rule was affirmed in *Scammon v. Kimball*, 92 U. S. 367; *Scovill v. Thayer*, 105 U. S. 152; and *Patterson v. Lynde*, 106 U. S. 519, 1 Sup. Ct. Rep. 432.

It is evident, from these decisions, that Muth could not himself offset the amount of these judgments against him for unpaid stock due from him to said railroad company. Now, can the company, or a creditor of the company, having a lien upon its property, compel him to credit the amount the company owes him upon these judgments, to the extent of the same? In order that one debt may be offset against another, the debts must be in the same right. But the supreme court, in the cases referred to above, say they are not in the same right. If Muth should be required to pay his subscription of stock to the said railroad company, the amount so paid might not be devoted to paying his debts against the company. It would be devoted to paying the claims of those who had the right to be first paid after the property of the company is exhausted, or to all the claims *pro rata*. There are in this case quite a number of judgments claimed to be liens against the property of the railroad company. Suppose it should turn out that there was not enough property belonging to the railroad company to satisfy the liens which are prior to those it is alleged the defendant Muth owns, then would not the subscription of stock of Muth be devoted to first paying off these liens under the decisions of the supreme court above referred to? I think this must be true. The rule to be established in such a case must be a general one, and apply to all similar cases. If it should appear that there might be cases in which the unpaid stock, if paid to the com-

pany, would not go to liquidating the claims of this stockholder who has not paid his subscription, I am sure there would be no right in any one to have the sum due the company to any extent set off against the debts such company might owe such stockholder. There might be cases where equity would decree such a set-off. If the party owning the claims against the company was notoriously insolvent, and there would be no chance for the unpaid subscription of stock of such a stockholder being liquidated, and hence no fund could arise for the paying of the claims which would be prior to his claims, then a court of equity might decree that these claims of such unpaid stockholder should be treated as a payment upon the unpaid stock subscription. Under such circumstances, a joint claim is sometimes allowed to be a set-off against an individual claim, although they are not held in the same right. Story, Eq. Jur. § 1437, 1437a. How far a court of equity might go, if such a case were presented, I am not now prepared to say. But no such case is here presented. It is not alleged that William Muth is insolvent.

It seems to be the approved practice in the courts of the United States for a creditor of a corporation, who has an unpaid claim against the same, and the property thereof is exhausted, to bring an action in the nature of a creditors' bill to compel a stockholder to pay in his unpaid subscription of stock. *Brown v. Fisk*, 23 Fed. Rep. 228; *Patterson v. Lynde*, 106 U. S. 519, 1 Sup. Ct. Rep. 432. And this action may be brought against one stock subscriber. *Hatch v. Dana*, 101 U. S. 205. This bill is allowed to be filed only after a judgment against the corporation, or when it is known to be insolvent. Then the suit is brought in such a way as to allow all parties who are creditors of the corporation to come in and be parties to the action, and share in its results. It would seem that, in this case, the intervener contemplated some such relief as is provided in a creditors' bill, and yet there is no provision for other creditors to join in asking such relief. There is no allegation that there has been any demand on Muth to pay his unpaid subscription of stock. Undoubtedly this demand can be made by a court of equity in behalf of the creditors, but before any demand can be made there must be ascertained, approximately, at least, how much Muth would be required to pay on his subscription. In the case of *Scovill v. Thayer*, *supra*, the supreme court said:

"The defendant owed the creditors nothing, and he owed the company nothing, save such unpaid portion of his stock as might be necessary to satisfy the claims of the creditors. Upon the bankruptcy of the company, his obligation was to pay to the assignees, upon demand, such an amount upon his unpaid stock as would be sufficient, with the other assets of the company, to pay

its debts. He was under no obligation to pay anything until the amount necessary for him to pay was, at least, approximately ascertained. Until then his obligation to pay did not become complete."

There is no allegation that in any way would show that it is yet ascertained how much Muth would be called upon to pay on his unpaid subscription of stock. The requiring him to set off the claims he has against the company in part liquidation of his subscription of stock would, in effect, be requiring him to pay the company so much of his subscription. I do not think the time has come when this can be done.

It is claimed that the case of *Emmert v. Smith*, 40 Md. 123, is an authority in point justifying the proceedings sought in this case. In that case the property of the corporation had been converted into money under a sale made by trustees in pursuance of an order of court, and the contest was as to the distribution of the proceeds among the creditors. In that case the court says:

"In the distribution of this fund in equity the creditors are severally actors, and each entitled to set up any equitable defense against each other. The provisions of the statute, without undertaking to prescribe any specific mode of recovery, make the stockholders of the company individually responsible to the creditors, and were designed for the relief of the creditors, and to afford them an ample and expeditious remedy before any forum competent to administer the law."

There is no statute in Montana which makes the stockholders of a railroad corporation individually liable to the creditors of the same for unpaid subscriptions of stock. In the case of *Terry v. Little*, 101 U.S. 216, the supreme court say: "The individual liability of stockholders in a corporation is always a creature of statute. It does not exist at common law. It will be seen that, while that was a different proceeding from that now presented in this case, there was also a different element for consideration, namely the individual liability of a subscriber of stock to a creditor. It would seem, also, that in that case the court did not consider the precise point presented in this,—namely, the right to have an individual claim against a corporation set off against an unpaid subscription of stock,—but whether this could be done without calling in all of the other stockholders who were indebted to the company for unpaid subscriptions of stock, and the liability of each determined, and only the amount each was required to contribute and pay in so as to liquidate the debts of the company determined. The court held that it could. That case, however, I do not consider in point in this case. For these reasons I think the demurrer should be sustained; and it is so held.



## CHAPTER X.

## BURGESS V. SELIGMAN.

SUPREME COURT OF THE UNITED STATES, 1882.

(107 U. S. 20.)

*Liability of Holder of Stock as Collateral.*

Mr. Justice Bradley:—This is an action brought by the plaintiff Burgess, against J. & W. Seligman & Co., as stockholders of the Memphis, Carthage & Northwestern Railroad Company, under a statute of the state of Missouri, to recover a debt due to him by the company. The plaintiff, in his petition alleges that on the fifth of November, 1874, judgment was rendered in his favor against the corporation by the district court of Cherokee county, Kansas, for \$73,661, which remains unsatisfied; that in December, 1874, the corporation was dissolved; and that the defendants, at the date of the dissolution and of the judgment, were, and still are stockholders of the corporation to the amount of \$6,000,000, on which there is due and unpaid \$1,000,000; and he demands judgment for the amount of his debt. Joseph Seligman, the principal defendant, answered, denying that the defendants were ever stockholders, or subscribers to the stock, of the corporation, and setting forth certain facts and circumstances (stated in the findings) under which the stock alleged to be theirs was merely deposited in their hands by the corporation in trust for a temporary purpose by way of collateral security, to be returned when that purpose was accomplished.

The cause was tried by the court, and judgment was rendered for the defendants on certain findings of fact; and the question here is whether the facts as found are sufficient to support the judgment.

The principle facts upon which the case must turn are substantially the following;

- The Memphis, Carthage & Northwestern Railroad Company was a corporation organized under the general laws of Missouri, with an authorized capital of \$10,000,000. On the tenth of March, 1872, a contract in writing was entered into between the corporation and J. & W. Seligman & Co., (the defendants), which is set forth in the findings. In the recitals of this contract it was

stated that certain municipal subscriptions, in the shape of bonds, to the amount of \$645,000 had been obtained in aid of its construction; and that a portion of the road (27 miles) was already graded, bridged and tied, and the right of way obtained, and all paid for by the proceeds of said subscriptions; and that the company now sought additional capital for procuring iron and equipment for the road by the sale of its first-mortgage bonds. It was, therefore, agreed that the railroad company should furnish the capital necessary to completely prepare the road for the iron, and would execute and deposit with the defendants its entire issue of first mortgage bonds, to-wit, \$5,000,000, and a majority of its capital stock authorized to be issued; "said stock to remain in the control of said party of the second part [J. & W. Seligman & Co.] for the term of one year at least." The latter agreed to purchase 2,000 tons of railroad iron under the railroad company's direction, and from time to time make advances of cash during the completion of the road, not exceeding \$200,000, (including the amount paid for iron,) and to receive interest thereon at the rate of 7 per cent. per annum until reimbursed by sale of the bonds. They were to have the privilege for the term of 12 months of calling any portion of the five million dollars of bonds at the rate of 70 cents currency and accrued interest less  $2\frac{1}{2}$  per cent., and if more bonds were sold than enough to iron the road, they should advance funds to purchase rolling stock, \$2,000 per mile, the balance to remain with them on deposit, on interest at the rate of call loans, to pay any deficiency in net earnings of the road to meet demands for interest on the bonds. If the bonds, or part of them, could not, for any unforeseen cause, be negotiated during the next 12 months, the company was to repay to J. & W. Seligman & Co. all moneys advanced by them, with interest at the rate of 7 per cent. per annum, and a commission of  $2\frac{1}{2}$  per cent. on all bonds returned. This is the purport of the written agreement.

On the first of May, 1872, a trust deed was executed by the company on its railroad and appurtenances to Jesse Seligman and John H. Steward, trustees to secure the company's bonds. On the eleventh of May, 1872, the following resolution of the directors was passed: "It is ordered by the board of directors that in making negotiations for money with J. & W. Seligman & Co., certificates for a majority of the capital stock of this company be issued to the said J. & W. Seligman & Co., *to hold in trust* for the period of 12 months, and that such certificates be signed by the president and secretary, with the corporate seal of this company affixed." A stock certificate for 60,000 shares, or \$6,000,000, was accordingly issued in the usual form to J. & W. Seligman & Co. This certificate was delivered to the defendants, but

the court finds that they never subscribed for the stock nor agreed to do so, and obtained it only in the manner set forth. The list of stockholders on the stock-book of the company, required by law to be kept, contains the names of certain townships which contributed aid to the road, and several individuals, including J. & W. Seligman, but not the amount of shares held. The stock transfer-book (also required by law) contained the same list, with date, number of shares, and amount carried out opposite to each name. The name of J. & W. Seligman appeared therein as follows:

NAMES.	RESIDENCE.	DATE.	NO. OF SHARES.	AMOUNT IN DOLLARS.
J. & W. Seligman.	New York, N. Y.	December 20, 1872.	60,000, sixty thousand, (held in escrow.)	6,000,000, six millions.

The court further found that shortly after the contract of of March 14, 1872, Joseph Shippen, an attorney of St. Louis, saw and examined its provisions, and a few days after told Burgess (the plaintiff) of the contract, and that thereby the Seligmans were to have control of the road, and of the stock and bonds, and told Burgess it would be well for him to have a talk with Joseph Seligman before entering into contract with the railroad for its construction. Burgess accordingly saw Seligman, and testifies that the following conversation ensued: "I told him I had been constructing on that Carthage road, and that I understood he was interested in the road now, and I would like to talk to him on that matter; that this company owed me—or Cunningham, who was the president of the corporation—that he owed me then some money for work I had done between there and Pierce City, and I wanted to know what the prospect was for pushing the work forward, the means of getting the iron, and so on, and he said: 'I think the best thing you can do is to go on with the work westward, and we will have ample means to get hold of the local bonds.' It seems Cunningham had represented to him that there was local means enough to grade the road, and he suggested to me then that I would be safe in going on and entering into such a contract, and then he mentioned that he thought it would be better for all parties if the road was built and the work prosecuted westward."

Afterwards, on June 14, 1872, Burgess entered into a contract with the railroad company for the construction of the road from Carthage, Missouri, to Independence, Kansas. He immediately began work under the contract, and so continued until the fall of

1873. The bonds of the company to the amount of \$864,000 were issued, and were negotiated and sold by J. & W. Seligman & Co., they themselves becoming holders of over \$400,000 thereof. The stock issued to them was voted on by *proxy* at two successive annual meetings for election of directors. The company being unable to meet its interest on the bonds, the road and property were delivered to the trustees of the mortgage and sold in December, 1874, and Joseph Seligman and Josiah Macy, as a bondholders' committee became purchasers thereof, and the railroad corporation was dissolved, in conformity with the laws of Missouri about the same time.

On the fifth of November, 1874, Burgess obtained judgment in the district court of Cherokee county, Kansas, against the railroad corporation for work and materials under his contract, for the sum of \$73,661, which judgment recited that it was entered by agreement, with a stipulation that it would be entitled to a credit of the amount which had been paid by the railroad company to subcontractors and laborers of the plaintiff, when the exact amount thereof should have been ascertained and proper vouchers furnished. No credits, however, were claimed. The present action was brought to recover the amount of this judgment. The findings also set out the contract made by Burgess and his associate with the railroad company, fourteenth June, 1872, for constructing the road, by which it appeared that they agreed to take their pay in township bonds, so far as the same should be furnished.

Upon these facts the court gave judgment in favor of the defendants. Burgess brings the case here by writ of error.

The statutory provision upon which the action is founded is the twenty-second section of article 1 of the act of Missouri relating to private corporations, (1 Wagner's St. c. 37,) which declares as follows:

"If any company, formed under this act, dissolve, leaving debts unpaid, suits may be brought against any person or persons who were stockholders at the time of such dissolution without joining the company in such suit, and if judgment be rendered and execution satisfied, the defendant or defendants may sue all who were stockholders at the time of dissolution for the recovery of the portion of such debt for which they were liable."

By section 9 of article 2, of the same chapter, it is enacted as follows:

"No person holding stock in any such company as executor, administrator, guardian, or trustee, and no person holding such stock as collateral security, shall be personally subject to any liability as a stockholder of such company, but the person pledging such stock shall be considered as holding the same, and shall

be liable as a stockholder accordingly, and the estates and funds in the hands of such executor, administrator, guardian, or trustee shall be liable, in like manner and to the same extent, as the testator or intestate, or the ward or person interested in such fund, would have been if he had been living and competent to act, and held the stock in his own name."

The first question for consideration is whether the plaintiff's claim was established. He relied on the judgment recovered by him against the corporation in Kansas. It is contended by the defendants that this judgment does not establish any debt due to the plaintiff. But we think that the objection is not sound. The judgment, as against the corporation and its privies, does establish the debt named therein as due to the plaintiff, but subject to a defeasance for such an amount as might be shown to have been paid to subcontractors and laborers by the corporation. The defendants, as well as the corporation, were at liberty to show any credits which, by the stipulation, were properly applicable in reduction of the amount of the judgment. None such were shown, or attempted to be shown. Until such credits were shown, the judgment stood valid for the whole amount. It was not for the plaintiff, but for the defendants, to show that any such credits existed.

The next and principal question is whether J. & W. Seligman & Co., or J. & W. Seligman were stockholders of the Memphis, Carthage & Northwestern Railroad Company within the meaning of the law. Did the 60,000 shares of stock belong to them? or did they hold it by way of trust or as collateral security for the fulfilment of the company's obligations in relation to the bonds? The courts in England, and some in this country, have gone very far in sustaining a liability for unpaid subscriptions to stock against persons holding the same in any capacity whatever, whether as trustees, guardians, or executors, or merely as collateral security. It cannot be denied that, in some cases, the extreme length to which the doctrine has been pushed has operated very harshly; and in cases in which the corporation itself has no just right to enforce payment, and where no bad faith or fraudulent intent has intervened, it may be doubted whether creditors have any better right, unless by force of some express provision of a statute. The Missouri statute recognizes the justice of making a discrimination between those who hold stock in their own right, and those who hold it merely in a representative capacity, or as trustees, or by way of collateral security.

Upon a careful examination of the facts found in this case we do not see how a reasonable doubt can exist that the Seligmans held the stock in question as trustees and custodians by way of collateral security for themselves and the purchasers of the bonds.

That was clearly the intent of the parties, declared in almost so many words; and that intent must prevail, unless by some inadvertency in carrying it out the Seligmans have been unwittingly caught in some legal snare of which the creditors can take advantage. By the contract executed between them and the corporation they were to act as its financial agents in the disposal of its bonds, and to make advances of money from time to time to enable the company to get the necessary iron for completing its road and equipment for running it. The company was to prepare the superstructure and procure the ties, and everything necessary by way of preparation for laying the iron down; and was to do this by means of the resources it had already secured, and expected to obtain, from the township subscriptions, in order that the mortgage to be given as security for the bonds might be good and valid for that purpose; and the company further agreed to *deposit* with Seligman & Co. a majority of its capital stock, to remain in their control for the term of one year at least. The reasonable inference is that this deposit of stock was to be made for the purpose alleged in defendant's answer, namely as security for the payment of the bonds, and to enable Seligman & Co. to control the corporation, and see that its affairs were honestly conducted and the earnings properly applied. The resolution of the directors, adopted for carrying out this agreement, is to the same purport and effect: it directs that, in making negotiations for money with Seligman & Co., certificates for a majority of the capital stock should be issued to them to hold *in trust* for the period of 12 months; and when the stock was entered upon the transfer-book in the name of J. & W. Seligman, it was characterized as being "held in escrow."

The terms used may not have been strictly technical. The issuing of the stock in their names may not have been a "deposit" or an "escrow" in the strict sense of those words; but the intent is very clear that the stock was not to be regarded as their stock, but as belonging to the company, though in their names, and that it was to be held by them simply as a security. They never subscribed for the stock; they never became indebted to the company for it; the company never acquired any right to demand from them a single dollar on account of it. Though issued in form, it was only issued in a qualified sense, to subserve a specific purpose by way of collateral security for a limited period, and was returnable to the company when that purpose should be accomplished. It seems to us that the Seligmans, in taking and holding the stock, held it merely in trust by way of collateral security for themselves and others, and that they were, therefore, within the express exception made by the law in favor of those holding stock in that way.

It is urged, however, that they are estopped from claiming the benefit of this exemption by their conduct in being represented and voting at stockholders' meetings. But if the law allows stock to be held in trust, or as collateral security, without personal liability, and if, as we suppose the clear effect of the contract was to create such a holding in this case, we do not see how the doctrine of estoppel can apply. The only parties to complain would be the other stockholders, who might, perhaps, complain that stock held merely in trust, or as collateral security, is not entitled to participate with them in the privilege of voting. But from them no complaint is heard. Creditors could not complain, for, on the hypothesis that stock may lawfully be held at all in trust, or as collateral security, without incurring liability to them, the act of voting on the stock cannot injure or affect them. In the absence of such a law the case might be very different. Undoubtedly it has been held, in cases innumerable, that acting as a stockholder binds one as such; but that is where the law does not allow stock to be held at all without incurring all the liabilities incident to such holding. The present is an action at law based upon the supposed liability of the defendants under a statute which makes the distinction referred to, and which does not make all stockholders liable indiscriminately. We think that this makes a material difference. If the defendants can show, as we think they have shown, that they are within the exception of the statute, the statutory liability does not apply to them.

It is by no means clear, however, that J. & W. Seligman did not have a right to vote on the stock, even as against the stockholders. When the law provides that if a person holds stock as a trustee, or by way of collateral security only, he shall not be personally liable for the company's debts, it supposes that the stock shall be holden, and that the pledgee or trustee shall be the holder. If, then, the law is to have any force or effect, the mere fact of holding cannot be set up as a bar or estoppel against proof of the manner and character of such holding. And if such pledgee or trustee may be a holder of the stock in that character, is he bound to be perfectly passive in his holding? He will not be entitled to any dividends or profits, it is true, or, if he receives dividends or profits, he must account therefor; but is it certain that he may not lawfully vote on the stock? An executor, administrator, guardian, or trustee certainly may vote; and where is the rule to be found that a holder for collateral security, under a law which permits such holding, may not vote on the stock so held without losing his character as a mere pledgee? But, as before said, if the pledgee, in voting the stock, exceeds his rights as such pledgee, it cannot have the effect of making the stock his own.

No one is injured, and no one can complain except the other stockholders whose rights are invaded.

The line of authorities usually quoted to show that those who actually hold stock, and who manifest a voluntary or intentional holding by voting on it, or receiving dividend or other benefit from it, consists mainly of cases, in which parties have been held as corporators, or associates as between themselves and the corporation or joint-stock association, and as such incidentally liable to the creditors of such companies. Sir Nathaniel Lindsley, in his able Treatise on Partnership, has amply discussed the whole subject upon the platform of the English decisions. His fundamental proposition is this: "The type, then, of a member or shareholder of a company is a person who has agreed to become a member, and with respect to whom all conditions precedent to the acquisition of the rights of a member have been duly observed. \* \* \* In practice, difficulties are only presented where this standard is not reached; and the important question really is to what extent it can be departed from, and membership be nevertheless constituted." Volume 1, p. 128. He then devotes many pages to show, by adjudged cases, how a man may be held as a corporator by the company itself, by holding himself out as such, as by taking dividends, etc. Now, in the present case, the relation of J. & W. Seligman & Co. to the corporation is expressly settled and fixed by the written contract between them. We have already examined that contract and have shown that the stock issued by the corporation to J. & W. Seligman & Co. was issued to them only as trustees and by way of collateral security. The proposition that the corporation could hold them as subscribers to its stock would be in flat defiance of the contract in whole and in every part. We do not know of any iron rule of law which would prevent them from showing this contract relation between them and the company. It is the origin and foundation of their whole connection with it. The sufficiency of the to control evidence their *status* towards the company is another thing. Its competency seems to us free from doubt. When examined, its hows as before stated, that as between them and the company the latter has no claim whatever against them in relation to the stock except to have it returned when properly required, after the purpose of its issue had been accomplished. It belongs to the company, and to it alone. J. & W. Seligman are mere trustees or custodians of it for a special purpose, that purpose being collateral security.

In this connection we may properly refer to the decision of the court of appeals of Maryland in the case of *Matthius v. Albert*, 24 Md., 527, which was a case arising upon the Maryland statute from which that of Missonri was copied, so far as relates to the



exception of those holding stock in trust or as collateral security. That was a suit in equity brought against stockholders to render them liable for the company's debts. One of them by the name of Tieman, had loaned money, to the corporation, and, as security for its payment, a certificate of stock had been issued to him. After its issue an indorsement was made on it by the president of the corporation to the effect that it had been deposited with Tieman as collateral security for the loan. The court said:

"The claim of W. H. Tieman is for \$2,000, money alleged to be loaned to the company on the eighth of January, 1859. But it is insisted by the appellees that Tieman, instead of being a non-stockholding creditor, is, according to the evidence, a stockholder, and as much liable as the Alberts. We do not concur in this view of the relation of Tieman to the company. In our opinion his claim is for money loaned, and the stock transferred to him was held by him as collateral security for his loan, and, so holding it he is not personally subject to any liability as stockholder, but is protected by the provision of the twelfth section of the act of 1852, c. 338."

A similar decision in a case arising upon a like statute in New York was made by the commissioners of appeal of that state in the case of *MacMahon v. Macy*, 51 N.Y.155. The New York railroad act of 1850, as amended by the act of 1854, made stockholders liable to creditors of the company for the amount unpaid on their stock; but the eleventh section of the act contained precisely the same provision as that in the ninth section of the Missouri law, that no person holding stock as executor, administrator, guardian, or trustee, and no person holding stock as collateral security, should be personally subject to any liability as stockholders, imposing the liability, however, as the Missouri law does, on the pledgee or *cestui que trust*. Macy was sued as a stockholder, and it was shown on the trial that the stock held by him was transferred to him as collateral security. The referee refused to give any effect to this evidence, holding that parol evidence could not be received to contradict or vary the written assignments or transfers, which were absolute in form. The commissioners of appeal, on this branch of the case, said:

"In this he erred. It is always competent to show that an assignment or conveyance absolute in form, was only intended as a security. There is nothing in any statute which makes the books of the company incontrovertible evidence of ownership of stock. A person may be the absolute legal and equitable owner of stock without any transfer appearing on the books."

All the judges of the commission concurred in this opinion.

We do not well see how any different conclusion could logically

have been arrived at. If the law declares that stock held as collateral security shall not make the holder liable, surely it must be competent to show that it is so held. And when this fact is once established, there is an end of the application of estoppel, unless it can be invoked by some party who has been specially misled by the conduct of the defendants.

It is urged by the plaintiff in this case that the defendants are estopped as to him, because of a certain conversation between Joseph Seligman and himself before he entered into the contract for construction. We have carefully examined the account given of this conversation by the plaintiff himself, and we see nothing in it which at all compromises the defendants on the question of their actual *status* and position in the affairs of the company. Especially may this be said in view of the fact that, prior to that conversation, an attorney, who had inspected the contract of Seligman & Co., told him of it, and that it would be well for him to have a talk with Joseph Seligman before entering into contract with the railroad company for its construction. The general purport of the conversation which he afterwards had with Seligman was that Seligman advised him to take the contract and go on with the work, as the best thing for all parties, as there would be ample means to get hold of the local bonds, which would be sufficient to grade the road. Surely there was nothing in this conversation to estop the defendants from showing what their real position was with regards to the stock which they held.

But the appellant's counsel, with much confidence, press upon our attention the decisions of the supreme court of Missouri on the questions involved in this case, and on the very transactions which we are considering. The court, since the determination of this case by the circuit court, has given judgment in two cases adversely to the judgment in this, and to the views above expressed. The first case was that of *Griswold v. Seligman*, decided in November, 1880; the other that of *Fisher v. Seligman*, decided in February 1882, in which the former case was substantially followed and confirmed. The case of *Griswold v. Seligman* seems to have been very fully and carefully considered. We have read the opinion of the court and the dissenting opinion of one of the judges with much attention, but we are unable to come to the conclusion reached by the majority.

We do not consider ourselves bound to follow the decisions of the state court in this case. When the transactions in controversy occurred, and when the case was under the consideration of the circuit court, no construction of the statute had been given by the state tribunals contrary to that given by the circuit court. The federal courts have an independent jurisdiction in the admin-

istration of state laws, co-ordinate with, and not subordinate to, that of the state courts, and are bound to exercise their own judgment as to the meaning and effect of those laws. The existence of two co-ordinate jurisdictions in the same territory is peculiar, and the result would be anomalous and inconvenient but for the exercise of mutual respect and deference. Since the ordinary administration of the law is carried on by the state courts, it necessarily happens that by the course of their decisions certain rules are established which become rules of property and action in the state, and have all the effect of law, and which it would be wrong to disturb. This is especially true with regard to the law of real estate and the construction of state constitutions and statutes. Such established rules are always regarded by the federal courts, no less than by the state courts themselves, as authoritative declarations of what the law is. But where the law has not been thus settled, it is the right and duty of the federal courts to exercise their own judgment; as they also always do in reference to the doctrines of commercial law and general jurisprudence. So, when contracts and transactions have been entered into, and rights have accrued thereon under a particular state of the decisions, or when there has been no decision of the state tribunals, the federal courts properly claim the right to adopt their own interpretation of the law applicable to the case, although a different interpretation may be adopted by the state courts after such rights have accrued. But even in such cases, for the sake of harmony and to avoid confusion, the federal courts will lean towards an agreement of views with the state courts if the question seems to them balanced with doubt. Acting on these principles, founded as they are on comity and good sense, the courts of the United States, without sacrificing their own dignity as independent tribunals, endeavor to avoid, and in most cases do avoid, any unseemly conflict with the well-considered decisions of the state courts. As, however, the very object of giving to the national courts jurisdiction to administer the laws of the states in controversies between citizens of different states was to institute independent tribunals, which, it might be supposed would be unaffected by local prejudices and sectional views, it would be a dereliction of their duty not to exercise an independent judgment in cases not foreclosed by previous adjudication. As this matter has received our special consideration, we have endeavored thus briefly to state our views with distinctness, in order to obviate any misapprehensions that may arise from language and expressions used in previous decisions.

In the present case, as already observed, when the transactions in question took place, and when the decision of the circuit court was rendered, not only was there no settled construction of the

statute on the point under consideration, but the Missouri cases referred to arose upon the identical transactions which the circuit court was called upon, and which we are now called upon, to consider. It can hardly be contended that the federal court was to wait for the state courts to decide the merits of the controversy and then simply register their decision; or that the judgment of the circuit court should be reversed merely because the state court has since adopted a different view. If we could see fair and reasonable ground to acquiesce in that view, we should gladly do so; but in the exercise of that independent judgment which it is our duty to apply to the case, we are forced to a different conclusion. The cases of *Pease v. Peck*, 18 How. 598, and *Morgan v. Curtenius*, 20 How. 1, in which the opinions of the court were delivered by Mr. Justice Grier, are precisely in point.

The cardinal position assumed by the state court is that, inasmuch as certificates of stock were in fact issued to and accepted by J. & W. Seligman, and they voted on the stock, they are absolutely estopped from denying that they are the owners of the stock, subject to all the liabilities incident to that relation; and that they cannot have the benefit of the exemption accorded by the law to those who hold stock as collateral security, because, as the court holds, that exemption only applies to those who have received stock in that way from some stockholder who can be made liable as a stockholder, not to those who have received stock from the corporation itself by way of collateral security.

The first position, that the acceptance of the stock, and voting upon it absolutely precluded the defendants from denying that they are owners of the stock, has been already considered. The great mass of authorities relied on by the supreme court of Missouri, on this part of the case, English as well as American, are cases in which parties have been held as corporators or associates as between themselves and the corporation, and upon that footing have been held responsible to creditors when the rights of creditors have been in question. We think that we have sufficiently shown that these authorities cannot govern the case in hand if any effect is to be given to the law of Missouri, exempting from personal liability those who hold stock in a fiduciary character or by way of collateral security. We will, therefore, briefly examine the other position, that this law does not apply to those who receive stock as collateral security from the corporation itself.

The argument that the exemption from liability in cases of stock held as collateral security applies only to those who have received it from third persons who were stockholders, and who can

be proceeded against as such, seems to us unsound, and contrary both to the words and the reason of the law. It takes for granted that stock cannot be received as collateral security from the corporation itself, and still belong to the corporation, and yet we know that such transactions are very common in the business of this company. The words of the statute are positive, and relate to all holders of stock for collateral security. They are as follows: "No person holding stock in any such company as executor, administrator, guardian, or trustee, and no person holding such stock as collateral security shall be personally subject to any liability as stockholder of such company." The reason of this law is derived from the gross injustice of making a person liable as the owner of stock, when he only holds it in trust or by way of security, and from the the inexpediency of putting a clog upon this species of property, which will have the effect of making it unavailable to the owner, or of deterring prudent and responsible men from accepting positions of trust where any such property is concerned. It seems to us that not only the law, but the reason upon which it is founded, applies to the holders of stock as collateral security, whether received from an individual or from the corporation itself. It is argued, however, that the remaining words of the law are repugnant to this view. These words are as follows:

"But the person pledging such stock shall be considered as holding the same, and shall be liable as a stockholder accordingly, and the estates and funds in the hands of such executor, administrator, or trustee shall be liable, in like manner and to the same extent, as the testator or intestate, or the ward or person interested in such fund, would have been, if he had been living and competent to act, and held the stock in his own name."

The argument is that these words imply that there must always be some person or estate to respond for the stock, or else the exemption cannot take effect. The obvious answer is that this clause fixes the liability upon the pledgor as a stockholder, where there is a pledgor who can be made liable in that character. When the corporation pledges its own stock as collateral security, though it cannot be proceeded against as a stockholder *eo nomine*, the reason is because it is primary liable, before all stockholders, for all its debts. In such a case, the clause last quoted would not strictly apply to it; but the holder of its stock as collateral security would be within both the letter and the spirit of the first clause. It is supposed that some flagrant injustice would ensue if there was not some one who could be reached as a stockholder in every case of stock pledged as collateral security; hence, stock pledged by the corporation itself must be regarded as belonging to the pledgee, though no other pledgee of stock is treated in this way. Where is the justice of this? Why should the stock

be necessarily considered as belonging to some one besides the corporation itself? Is anyone harmed by considering the corporation as its true owner? If the stock had not been issued as collateral security, it would not have been issued at all; it would not have been in existence. Would the creditors have been any better off in such case? They are better off by the issue of the stock as collateral, because the general assets of the company have received the benefit of the moneys obtained by means of the pledge. The more closely the matter is examined, the more unreasonable it seems to deny to a pledgee of the corporation the same exemption which is extended to the pledgee of third persons. We think that the one equally with the other is protected by the express words and true spirit of the law.

We might pursue the subject further, and examine in detail the suggestions and authorities adduced by the learned court which decided the cases of *Griswold v. Seligman* and *Fisher v. Seligman*, but it is unnecessary. What we have said is sufficient to indicate substantially the grounds on which we feel obliged to dissent from its conclusions. In our judgment the facts found by the court below make out a clear case of stock held in trust and by way of collateral security only, and the judgment rendered thereon was correct.

Judgment affirmed

## CHAPTER XI.

## CORPORATE MEMBERSHIP — LIABILITY INDEPENDENT OF STATUTE.

## HANDLEY V. STUTZ.

SUPREME COURT OF THE UNITED STATES, 1890.

(139 U. S. 417.)

*Liability on Stock Issued Below Par.*

This was a bill in equity, filed by Sebastian Stutz, of Pittsburg, Pa., by certain other persons composing the firm of Ragon Brothers, of Evansville, Indiana, and by others composing the firm of Louis Stix & Co., of Cincinnati, Ohio, on behalf of themselves and such other creditors of the Clifton Coal Company as should come in and contribute to the expense of a suit, against the Clifton Coal Company and certain of its stockholders, to compel an assessment upon certain shares of stock held by the individual defendants, and payment of the same as a trust fund for the satisfaction of the debts of the company. The bill averred in substance that the Clifton Coal Company was incorporated under the laws of the State of Kentucky, in July, 1883, with power to purchase, lease and operate coal mines in the State of Kentucky, a copy of the articles of incorporation being annexed to the bill; that by said articles the capital stock of such corporation was fixed at \$120,000, divided into shares of \$100 each, with power to increase the same to \$200,000, by a majority vote of the stockholders; that all the stock was then taken and paid for by the subscribers in some manner agreed upon between them; that, pursuant to the authority contained in the articles of incorporation, the stockholders, all of them being present and voting, "at a meeting duly held for the purpose in May, 1886, unanimously resolved and ordered that the capital stock of said company be, and in fact was then increased to \$200,000 in shares of \$100 each, being an increase of 800 shares of stock of said company;" that of the 800 shares then created, the defendant Handley subscribed for 86¾ shares, two of the other defendants for 15 shares each, and two others for 75 shares each, certificates of which were issued by the company,

and delivered to and received by, said subscribers as they were respectively entitled; but that neither one of them ever paid to the company any part of the said shares, and they each, respectively, owe the said company the full par value of the shares of the said capital stock subscribed for and issued to them.

The bill also averred that on December 30, 1886, it having been previously resolved to issue bonds to the amount of \$50,000, and to secure the payment thereof by a mortgage upon its property, and said mortgage having been executed to trustees and recorded, a contract was executed and delivered to the company by certain others of the defendants, whose names were subscribed thereto, in the following terms: "We, the undersigned, subscribe for the amount set opposite our names respectively, to bonds of the Clifton Coal Company, aggregating \$50,000. It is agreed that \$50,000 capital stock be distributed *pro rata* among the subscribers to the above bonds;" that several of the defendants subscribed to this contract, and agreed to take bonds in different amounts; that said subscribers paid the coal company for the bonds, and that with the money thus received, to the extent of \$30,000, the company paid its debts to certain of its officers and managers, who had become liable by indorsement for the company, and that nothing was or ever has been paid for or upon any of the shares of capital stock thus subscribed for, and to be distributed among them; that is to say, \$50,000 of said capital stock, equivalent to 500 shares thereof, was in fact subscribed for and distributed among certain of the defendants, to whom in May, 1887, there were issued and received by them respectively certificates for shares.

The bill further averred that the plaintiffs were judgment creditors of the company, by judgments obtained in the courts of Kentucky; that their debts were created before all of the capital stock of said company was paid in; and that all of said \$80,000 increase of the capital stock, and each and all of the amounts due to the company for any part of its capital stock, constituted a trust fund for their benefit, which they were entitled to have administered in a court of equity to the satisfaction of their said debts, the company being insolvent.

It further appeared from the testimony that the company was organized soon after its articles of incorporation were filed; that its chief office was at Mannington, Kentucky; and that it began business at once and made large outlays and expenditures for machinery, buildings, materials and labor. In the early part of the year 1886, the company was led to believe that its coal would coke, and therefore its products could be profitably extended from grate and steam purposes to iron-making coke. To embark in the manufacture of coke, however, money was needed,



and a meeting of the stockholders was held March 31, 1886, at which a resolution was passed, reciting that \$50,000 was needed with which to erect coke ovens, buildings, improvements, etc., to further develop the property; and it was unanimously resolved to issue \$50,000 of bonds of the company, in sums of \$1,000 each, due thirty years from April 1, with 6 per cent. interest, and secured by trust mortgage upon the property of the company, and the president was authorized to dispose of such bonds as in his discretion seemed best. The mortgage was executed to the designated trustee and recorded. It was found, however, that the bonds could not be sold, and to meet the demands upon the company for money, it borrowed a large amount upon its notes, indorsed by its directors and stockholders and to secure the lenders and indorsers, the \$50,000 of bonds were deposited in two banks in Nashville, Tennessee, as additional collateral security for the loans. Finding that no one would purchase the bonds, and being advised that in order to effect their sale it would be better to add an equal amount of stock to the bonds, and propose to the purchasers of such bonds to give as a gratuity \$1,000 of stock with each \$1,000 bond, a meeting of the stockholders of the company was held at Nashville, May 31, 1886, at which all the stockholders were present in person or by proxy, although without any call or previous notice and "it was unanimously resolved that the capital stock of the company be increased to \$200,000, as authorized by the charter." This resolution was not then entered upon the records of the corporation, but was formulated in the shape of a pencil memorandum, and adopted unanimously, although no vote appeared to have been taken, and no formal record was made of the meeting until the summer of 1888. No notice of such change in the amount of its capital stock was recorded or published, as required by the laws of Kentucky. The subscribers to the bonds subsequently executed the agreement set forth in the bill, and bonds to the amount of \$45,000 were delivered to the subscribers with equal amounts of certificates of "paid-up" stock, the receipts reciting that it "was issued with bonds for same amount, as per agreement." The certificates on their face recited that the shares of stock were fully paid up "and were non-assessable," or language to that effect. Five thousand dollars of the bonds were left in one of the national banks at Nashville as collateral security for a loan to the company, no one having subscribed for them. The remaining \$30,000 shares of increased stock, which were not needed to secure the subscribers to the bonds, appeared to have been distributed *pro rata* among the old stockholders. In the latter part of 1887, and in the early part of the following year, plaintiff obtained judgments against the company, which were unsatisfied,

and in September, 1887, by an order of the Circuit Court of Hopkins County, Kentucky, the entire property of the company was placed in the hands of a receiver, and its operation stopped.

On February 8, 1889, this bill was filed against the coal company and the holders of this increased stock, to compel payment therefor, and to recover the amounts of the judgments against the company. The court dismissed the bill as to three of the defendants not served with process, and as to the rest held them liable to all the creditors of the company whose debts originated after the alleged increase of stock, and fixed May, 1886, as the date of such increase. As to debts contracted prior to that date, they were excluded because, as between the company and the stockholders, the latter held such stock properly, and without liability to the company and all creditors who dealt with the company prior to such increase, and not upon the faith of such stock, had no equity to demand more than the company itself could. Five of the defendants against whom decrees were rendered in excess of \$5,000 appealed to this court, and the circuit court suspended the execution of the decree as to those who could not appeal until this court should determine the rights of the appellants.

The opinion of the circuit court is reported in 41 Fed. Rep. 531.

Mr. Justice Brown delivered the opinion of the court:

1. Although the resolution of May 31, 1886, increasing the stock of the company from \$120,000 to \$200,000, was not formally entered at that time upon the books of the company, and nothing but a pencil memorandum was then made of the proceedings of the meeting, no objection can be taken to its validity by reason of such omission. The testimony shows clearly what took place at this meeting. It appears from the memorandum made by Mr. Allen, the acting secretary, to have been "unanimously resolved that the capital stock of the company be increased to \$200,000 as authorized by the charter, the purposes for which said stock is issued being the betterment of the present plant, and the construction of a new plant for coking purposes." This resolution was subsequently and in 1888, when the omission to record the same appears to have been first discovered, formally entered upon the minute book of the corporation. The failure to enter this resolution at the time it was adopted did not affect its validity, as most corporate acts can be proved as well by parol as by written entries. *Moss v. Averell*, 10 N. Y. 449.

2. Nor were the proceedings of such meeting any less binding upon those participating in it by reason of the fact that it was held without call or notice, and outside the boundaries of the State under the laws of which the company was incorporated.

By an Act of the legislature of Kentucky, of March 3, 1876 (General Statutes, page 769), "all elections for directors and other officers, by private corporations, etc., shall be held within the territorial limits of the State of Kentucky . . . Any such election held outside of Kentucky shall be void." Beyond the election of officers, however, there is no statutory restriction of corporate action to the limits of the State, and in the absence of such inhibition the proceedings of such meeting would, within the rule laid down by this court in *Galveston, H. & H. R. Co. v. Cowdrey*, 78 U. S. 11 Wall. 459, with regard to directors' meetings, be binding upon all those participating in, as well as upon those acting upon the faith of its validity, or receiving stock authorized to be issued at such meeting. It is true there are cases holding that stockholders' meetings cannot be legally held outside of the home State of the corporation, but the question has generally arisen where a majority present at such meeting had attempted by their action to bind a dissenting minority, or had taken action prejudicial to the rights of third persons. *Ormsby v. Vermont Copper Min. Co.* 56 N. Y. 623; *Hilles v. Parish*, 14 N. J. Eq. 380. Indeed, so far as we know, the authorities are uniform to the effect that the action taken at such meetings is binding upon those who participate in or take the benefit of them. *Heath v. Silvertown Lead Min. Co.* 39 Wis. 146. In this case the meeting was attended by all the stockholders but two, who were represented by proxy, the vote increasing the stock was unanimous, and it does not lie in the mouth of those who participated in this act or received the stock voted at this meeting to question its validity.

3. It is further claimed that this issue of stock was invalid by reason of the fact that there was no amendment of the charter authorizing such increase ever recorded or published, as required by the law of Kentucky. The proceeding for the organization of incorporated companies is found in chapter 56 of the General Statutes of Kentucky, the fifth section of which requires a notice to be published for at least four weeks in some newspaper as convenient as practicable to the principal place of business, specifying several particulars, among which is the amount of capital stock authorized, and the times when, and the conditions upon which it is to be paid in. Section six is as follows: "The corporation may commence business as soon as the articles are filed for record in the office of the county court clerk, and their acts shall be valid if the publication in a newspaper is made, and the copy filed in the office of the secretary of state, when such filing is necessary within three months from such filing in the clerk's office, No change in any of the foregoing particulars shall be valid, unless recorded and published as the ori-

ginal articles are required to be; nor shall any change be made at any time or in any manner which would be inconsistent with the provisions of this Act." Reliance is placed upon the final clause of this section, for the position assumed by the defendants, that the increase in the capital stock, never having been recorded or published, as required by this clause was, void and the case of *Scoville v. Thayer*, 105 U. S. 143, is cited in support of this contention. That was also an action to recover unpaid assessments upon stock. The statutes of Kansas provided that any corporation might increase its capital stock to any amount not exceeding double the amount of its authorized capital. The corporation in question had increased its capital stock, as it was authorized to do, by doubling it, and it subsequently increased it by doubling it again, thus quadrupling the original amount, the defendant in the case having attended by proxy the meeting at which such illegal increase was voted, and received a quantity of stock thus issued. It was held that such increase was *ultra vires* and void, and that the defendant was not estopped from denying the validity of the over-issue, or his obligation to pay for it.

In the case under consideration, however, the articles of incorporation did provide that the capital stock should be \$120,000 with power to increase to \$200,000 by a majority vote of the stockholders, and there was no statutory inhibition, as in Kansas, against any such increase as it might be thought advisable to make. Here, then, was the power to increase the capital stock to the precise amount fixed by the stockholders, at their meeting at Nashville, and the defect was merely in the failure to record and publish such change, as required by section six of the Statute in question.

It is insisted by the appellees, that the learned judge of the circuit court so held, that the failure to record and publish this increase of the capital stock, which was in fact, if not in name, an amendment to the original articles, which had fixed the capital stock at \$120,000, was a mere irregularity and informality in the proceedings to effect the increase; such a one as was said by this court in *Chubb v. Upton*, 95 U. S. 665, 667 to constitute no defense to a subscriber to such increased stock. In that case it appeared only that objection was made to the proceedings by which the company increased its stock, on the ground of irregularity and informality in the papers filed in the public offices; and it was held that one who contracted with an acting corporation, by purchasing stock in the same, could not defend himself against a claim upon such contract, in a suit by the corporation, by urging the illegality of its organization. In

*Veeder v. Mudgett*, 95 N. Y. 295, 310, which was also an action by directors against the stockholders of a corporation to enforce the liability imposed upon them because of an alleged failure to pay in the full amount of the capital stock, it appeared that the meeting at which the increased stock was voted was not formally called, nor was a certificate of the increase of capital made and filed as prescribed by the State statute. The stock was, however, all issued to stockholders who voted for the increase. These holders subsequently received dividends thereon, voted at stockholders' meeting and in all respects were treated and acted as stockholders. The court held the attempted increase illegal, but that the defendant stockholders, as against the creditors of the company, by accepting their proportions of the increased stock, by voting for its increase, by taking dividends upon it and by holding it out to those dealing with the company as an actual component of its capital, were estopped from denying the validity of the increase. It was argued in that case, as it is in this, that an act absolutely and wholly void, because incapable of being performed, could not be made valid by estopped. But this was held to be true only where there was an entire lack of power to do the act so brought in question, and the case of *Scoville v. Thayer* was cited. "But where," says the court, "as in the present case, the abstract power did exist, and there was a way in which the increase could lawfully be made, and the creditors acted without fault, believing that the increase had been lawfully effected, and the necessary steps had been taken, there the doctrine of estopped may apply and the increased stock be deemed valid as against the creditors who have acted upon the faith of such increase.

It is true that in neither of those cases was the court embarrassed by a statute declaring that certain conditions must be observed or the increase would not be valid. But we think that the clause of section 6, upon which reliance is placed, must be read in connection with section 18 of the same act, which provides that "no persons, acting as a corporation, under the provisions of this act shall be permitted to set up or rely upon the want of a legal organization as a defense to action brought against them as a corporation; nor shall any person who may be sued on a contract made with such corporation, or sued for an injury done to its property, or for a wrong done to its interests, be permitted to rely upon such want of legal organization in his defense." It is true that this section seems to apply rather to a want of an original legal organization of the company; but we think it should be regarded as applying as well to amendments to such organization, and that no defense connected with the original organiza-

tion, which a party contracting with the corporation would be disqualified to set up, can be made available in connection with an amendment to the original articles.

So far as the question of liability to the proposed assessments is concerned, these defendants, with respect to their relations to this corporation, are divisible into two distinct classes: *first*, those of the original stockholders who received the \$30,000 increased stock as a gift; *second*, those who subscribed to the \$50,000 bonds, and received an equal amount of stock as a bonus or inducement to make the subscription.

4. "With regard to the first class, namely, the original stockholders, who voted for this increase of shares, and then distributed among themselves 300 of those shares, without the shadow of right or consideration, it is difficult to see why they could not be called upon to respond for their value. The only claim made upon their behalf is that they never agreed to contribute or pay for the same; that the stock was expressly declared to be "fully paid" and "free from all claims or demands upon the part of the company;" that there was no evidence that the creditors of the company knew of, or relied upon, this increase, in their dealings with the company; and that they had a right to return and surrender the same, which they offered to do. There is no reason to suppose that these stockholders did not act in good faith, and in the belief that they were entitled to this stock. The fact that they did not subscribe for it or agree to take it until the receipt of the certificates is immaterial, as the acceptance of the certificates is sufficient evidence of an agreement to pay their par value. *Sanger v. Upton*, 91 U. S. 56, 64; *Chubb v. Upton*, 95 U. S. 665; *Brigham v. Mead*, 10 Allen, 245.

Ever since the case of *Sawyer v. Hoag*, 84 U. S. 17 Wall. 610, it has been the settled doctrine of this court that the capital stock of an insolvent corporation is a trust fund for the payment of its debts; that the law implies a promise by the original subscribers of stock who did not pay for it in money or other property to pay for same when called upon by creditors; and that a contract between themselves and the corporation, that the stock shall be treated as fully paid and non-assessable, or otherwise limiting their liability therefor, is void as against creditors. The decisions of this court upon this subject have been frequent and uniform, and no relaxation of the general principle has been admitted. *Upton v. Tribilcock*, 91 U. S. 45; *Sanger v. Upton*, 91 U. S. 56; *Webster v. Upton*, 91 U. S. 65; *Chubb v. Upton*, 95 U. S. 665; *Pullman v. Upton*, 96 U. S. 328; *Morgan County v. Allen*, 103 U. S. 498; *Hawkins v. Glenn*, 131 U. S. 319; *Graham v. La Crosse & M. R. Co.*, 102 U. S. 148, 161; *Richardson v. Green*, 133 U. S. 30.

It is simply in affirmative of this general principle that section 14, chapter 56, of the General Statutes of Kentucky declares that nothing in the Act conferring corporate franchises, or permitting the organization of corporations, "shall exempt the stockholders of any corporation from individual liability to the amount of the unpaid installments on stock owned by them." If the corporation has no right, as against creditors, to sell or dispose of this stock with an agreement that no further assessment shall be made upon it, much less has it the right to give it away, or distribute it among shareholders, without receiving a fair equivalent therefor, and thereby induce the public to deal with it upon the credit of such shares, as representing the assets of the corporation. *Upton Mutual L. Ins. Co. v. Free Stone Mfg. Co.*, 97 Ill. 537. The stock of a corporation is supposed to stand in the place of actual property of substantial value, and as being a convenient method of representing the interest of each stockholder in such property, and to the extent to which it fails to represent such value, it is either a deception and fraud upon the public, or an evidence that the original value of the corporate property has become depreciated. The market value of such shares rises with an increase in the value of the corporate assets, and falls in case of loss or misfortune, whereby the value of such assets is impaired. And the increase of value of such stock is taken to represent either an appreciation in value of the company's property beyond the par value of the original shares, or so much money paid to the corporation as is represented by such shares. If it be once admitted that a corporation may issue stock without receiving a consideration therefor, and where it does not represent actual or substituted value in corporate assets, there is apparently no limit to the extent to which the original stock may be "watered," except the caprice of the stockholders. While an agreement that the subscribers or holders of stock shall never be called upon to pay for the same may be good as against the corporation itself, it has been uniformly held by this court not to be binding upon its creditors.

5. Somewhat different considerations apply to those who subscribed for the bonds of the company, with the understanding that they were to receive an amount of stock equal to the bonds as an additional inducement to their subscription. The facts connected with this transaction are substantially as follows: Some three years after the company was organized it became apparent that the enterprise, as originally contemplated, namely the mining and selling of coal for steam and domestic purposes, was not likely to be a success, owing to the inferior character of the product; and the only hope of the company lay in the manu-

facture of the coal into an iron-making coke, that is, a coke containing a percentage of sulphur low enough to admit of the manufacture of merchantable pig-iron. To embark in this, however, money was needed, and as the stock of the company was not worth more than fifty cents on the dollar, it was evident this could not be effected simply by the issue of new stock. It was proposed at the meeting in March that money should be raised by the issue of \$50,000 of bonds, with which to add the requisite structures to the plant. But it was soon evident that the bonds could not be negotiated without the stock, and acting upon the suggestion of a Nashville banker, it was resolved at the meeting in May that the stock should be increased 800 shares, 500 of which should be turned over to the subscribers to the bonds, as a bonus or an additional consideration. The evidence is uncontradicted that the bonds could not have been negotiated without the stock; that they were both sold as whole; that the transaction was in good faith, and, considering the risk that was taken by the subscribers, the price paid for the stock and bonds was fair and reasonable. The directors appear to have done all in their power to obtain the best possible terms, and there is no imputation of unfair dealing on the part of anyone connected with the transaction. At that time the mines and property of the company were in good condition, and the prospects of success were fair.

The case then resolves itself into the question whether an active corporation, or, as it is called in some cases, a "going concern," finding its original capital impaired by loss or misfortune, may not, for the purpose of recuperating itself and providing new conditions for the successful prosecution of its business, issue new stock, put it upon the market and sell it for the best price that can be obtained. The question has never been directly raised before in this court, and we are not, consequently, embarrassed by any previous decisions on the point. In the *Upton Cases* arising out of the failure of the Great Western Insurance Company, in *Hatch v. Dana*, 101 U. S. 205, and in *Hawkins v. Glenn*, 131 U. S. 319, the defendants were either original subscribers to the increased stock, at a price far below its par value, or transferees of such subscribers; and the stock was issued, not as in this case, to purchase property or to raise money, to add to the plant and facilitate the operations of the company, but simply to increase its original stock in order to carry on a larger business, and the stock thus issued was treated as if it formed a part of the original capital. In *Morgan County v. Allen*, 103 U. S. 498, the same principle was applied to a subscription by a county to the capital stock of a railroad com-



pany, for which it had issued its bonds, although such bonds had been surrendered to the county with the consent of certain of its creditors.

To say that a corporation may not, under the circumstances above indicated, put its stock upon the market and sell it to the highest bidder, is practically to declare that a corporation can never increase its capital by a sale of shares, if the original stock has fallen below par. The wholesome doctrine, so many times enforced by this court, that the capital stock of an insolvent corporation is a trust fund for the payment of its debts, rests upon the idea that the creditors have a right to rely upon the fact that the subscribers to such stock have put into the treasury of the corporation in some form, the amount represented by it; but it does not follow that every creditor has a right to trace each share of stock issued by such corporation, and inquire whether its holder, or the person of whom he purchased has paid its par value for in. It frequently happens that corporations, as well as individuals, find it necessary to increase their capital in order to raise money to prosecute their business successfully, and one of the most frequent methods resorted to is that of issuing new shares of stock and putting them upon the market for the best price that can be obtained; and so long as the transaction is bona fide, and not a mere cover for 'watering' the stock, and the consideration obtained represents the actual value of such stock, the courts have shown no disposition to disturb it. Of course no one would take stock so issued at a greater price than the original stock could be purchased for, and hence the ability to negotiate the stock and to raise the money must depend upon the fact whether the purchaser shall or shall not be called upon to respond for its par value. While, as before observed, the precise question has never been raised in this court, there are numerous decisions to the effect that the general rule that holders of stock, in favor of creditors must respond for its par value, is subject to exceptions where the transaction is not a mere cover for an alleged increase.

Thus in *New Albany v. Burke*, 11 Wall 97 a city subscribed to the stock of a railroad and issued bonds for a part of the subscription, agreeing to issue them for the rest of it when the road should be built to a certain point. The road relied mainly upon these bonds to raise the necessary money. The validity of the bonds being denied by taxpayers who had filed bills to enjoin the raising of a tax to pay the interest, their value in the market was largely impaired, and it was found they could not be sold without a sacrifice. Under these circumstances the company applied to the city to pay a certain sum which had been borrowed by the road upon the pledge of the bonds already

issued, with sundry other moneys, and in consideration thereof the city obtained from the company a large number of bonds which had not been negotiated, and a cancellation of the subscription. In a suit brought by a judgment creditor to enforce the original subscription, it was held that the compromise was legal, and the payment of such subscription would not be enforced, although it subsequently turned out that the bonds were more worth than they could have been sold for. Said Mr. *Justice Strong*, speaking for the court: "Had the company sold to a stranger, and then the city become a purchaser from the stranger, it will not be contended that any creditor of the company could complain. And it can make no difference whether the purchase was made directly or indirectly from the first holder of the bonds, assuming that there was no fraud. The transaction . . . was, in substance, plainly nothing more than a purchase by the city of its own bonds, some of which had been issued and others of which it was under obligation to issue, at the call of the vendor. . . . Looking at it in the light of subsequent events, it was no doubt an advantageous purchase for the city; and, if the uncontradicted evidence is to be believed, it was deemed at the time an advantageous sale or arrangement for the company. . . . We may add, the evidence is convicting that the contract between the city and company was made in the utmost good faith, with no intention to wrong creditors of the latter; that it was at the time considered advantageous to the company, and it is not proved that all was not paid for the bonds issued and to be issued that they could have been sold for in the market."

So in *Coit v. Gold Amalgamating Co.*, 119 U. S. 343, it was held that where the charter of a corporation authorizes the capital stock to be paid for in property, and the shareholders honestly and in good faith pay for their subscription in property instead of money, third parties have no ground of complaint, although a gross and obvious over-valuation of such property would be strong evidence of fraud in an action by a creditor to enforce personal liability. The court held that where full-paid stock was issued for property received there must be actual fraud in the transaction to enable creditors of the corporation to call the stockholders to account. In delivering the judgment of the court in that case at the circuit (14 Fed. Rep. 12), Mr. *Justice Bradley* observed: "That trust (in favor of creditors) does not arise absolutely in every case where capital stock has been issued, and where it has been settled for by arrangement with the company. It is not as if the stockholders had given their promissory notes for the amount, these notes being in the treasury of the company; but there are often equities to which the stockholders are entitled—on which they are to

stand." As one of them, he mentioned the case where stock dividends fairly made in consideration of profits earned and of accumulations of the property of the company and observed: "It is not true that it is in the power of a creditor in every case, and in all cases, as a mere matter of right, to institute an inquiry as to the valuation of the amount of the consideration given for the stock, and disturb fair arrangements for its payment in other ways than by cash. If the stock has been fairly created and paid for, there is an end of trusts in favor of anybody; and this does not affect the general proposition that unpaid subscriptions of stock are a trust fund to be administered for the benefit of creditors after a corporation becomes insolvent."

A case nearer in point is that of *Clark v. Bever*, 139 U. S. 96 decided at the present term of this court. In this case, a railroad company, of which defendant's intestate was president and stockholder, had a settlement with a construction company, of which defendant's intestate was also a member, for work done in building the road. The railroad company, being unable to pay the claim of the construction company, delivered to it thirty-five hundred shares of its stock at 20 cents on the dollar, and the same were accepted in full satisfaction of the debt. The stock was not worth anything in the market, and was issued directly to the defendant's intestate. No other payment than the 20 per cent. was ever made on account of this stock. A judgment creditor of the railroad company filed a bill to compel the payment by the defendant of his claim upon the theory that he was liable for the actual par value of such stock, whatever may have been its market value at the time it was received. It was held he could not recover. "Of course under this view," said Mr. Justice Harlan, in delivering the opinion of the court, "everyone having claim against the railway company,—even laborers and employes,—who could get nothing except stock in payment of their demands, became bound, by accepting stock at its market value in payment, to account to unsatisfied judgment creditors for its full face value, although, at the time it was sought to make them liable, the corporation had ceased to exist, and its stock had ceased to exist, and its stock had remained, as it was when taken, absolutely worthless. . . . To say that a public corporation, charged with public duties, may not relieve itself from embarrassment by paying its debt in stock at its real value,—there being no statute forbidding such a transaction,—without subjecting the creditor, surrendering its debt, to the liability attaching to stockholders who have agreed, expressly or impliedly to pay the face value of stock subscribed by them, is, in effect, to compel them either to suspend operations the moment they be-

come unable to pay their current debts or to borrow money secured by mortgage upon the corporate property."

So in *Fogg v. Blair*, 139 U. S. 118, also decided at the present term, it was held to be competent for a railroad, exercising good faith, to use its bonds or stock in payment for the construction of its road, although it could not, as against creditors or stockholders' issue its stock as fully paid without getting some fair or reasonable equivalent for it. It was there said: "What was such an equivalent depends primarily upon the actual value of the stock at the time it was contracted to be issued, and upon the compensation which, under all the circumstances, the contractors were equitably entitled to receive for the particular work undertaken or done by them." It appeared in that case that full and adequate compensation for the work done had been paid by the company in its mortgage bonds, and, as the bill contained no allegation whatever as to the real or market value of such stock, it was held that the contractors receiving this stock were not liable to creditors for its par value. It was added: "If, when disposed of by the railroad company, it was without value, no wrong was done to creditors by the contract made with Blair and Taylor. If the plaintiff expected to recover in this suit on the ground that the stock was of substantial value, it was incumbent upon him to distinctly allege facts that would enable the court—assuming such facts to be true—to say that the contract between him and the railroad company and the contractors was one which, in the interest of creditors, ought to be closely scrutinized." It would seem to follow from this that if the stock had been of some value, that value, however much less than par, would have been the limit of the holder's liability.

In *Morrow v. Nashville I. S. Co.*, 87 Tenn. 262, the Supreme Court of Tennessee held that a contract with a subscriber to stock of a corporation, that for every share subscribed he should receive bonds to an equal amount, secured by mortgage on the company's plant, is void as against creditors, and also between the subscriber and the corporation. But the court drew distinction between such a case and sales of or subscription to the stock of an organized and going corporation. It said: "The necessities of the business of an organized company might demand an increase of capital stock, and if such stock is lawfully issued, it may very well be offered upon special terms. In such case, if the market price was less than par, it is clear that a purchaser or subscriber for such stock at its market value would, in the absence of fraud, be liable only for his contract price. So a case might arise where the stock of a going concern was much depreciated, and where its bonds were likewise below par, and there

was lawful authority to issue additional stock and bonds. Now, in such case, the real market value of an equal amount of stock and bonds might not exceed, or even equal the par value of either. In such cases, the question of fraud aside, the purchaser would only be held for his contract price." This case from Tennessee puts as an illustration the exact case with which we are now dealing.

The liability of a subscriber for the par value of increased stock taken by him may depend somewhat on the circumstances under which, and the purpose for which, such increase was made. If it be merely for the purpose of adding to the original capital stock of the corporation, and enabling it to do a larger and more profitable business, such subscriber would stand practically upon the same basis as a subscriber to the original capital. But we think that an active corporation may, for the purpose of paying its debts, and obtaining money for the successful prosecution of its business, issue its stock and dispose of it for the best price that can be obtained. *Stein v. Howard*, 65 Cal. 616. As the company in this case found it impossible to negotiate its bonds at par without the stock, and as the stock was issued for the purpose of enhancing the value of the bonds, and was taken by the subscribers to the bonds at a price fairly representing the value of both stocks and bonds, we think the transaction should be sustained, and that the defendants cannot be called upon to respond for the par value of such stock, as if they had subscribed to the original stock of the company. Our conclusion upon this branch of the case disposes of it as to those who were held liable by virtue of their subscription to the bonds.

6. "We have no doubt the learned circuit judge held correctly that it was only subsequent creditors who were entitled to enforce their claims against these stockholders, since it is only they who could, by any legal presumption, have trusted the company upon the faith of the increased stock. *First Nat. Bank of Deadwood v. Gustin Minerva Con. Min. Co.*, 42 Minn. 327; 2 Morawetz on Corporations §§ 832, 833; *Coit v. North Carolina Gold Amalgamating Co.*, 14 Fed. Rep. 12. We also agree with him that creditors, who became such after the increase was voted in May, 1886, are entitled to look to those who subsequently received the stock, notwithstanding they did not receive it until after the debts had been contracted. The circuit judge found in this connection that the "complainants had no knowledge or notice of the subscription paper of December 30, 1880, under which \$45,000 of the new stock was distributed to those who subscribed for bonds, nor of the distribution among the old stockholders of \$30,000 of said increased stock; nor does it affirmatively appear that they or either of them dealt with and

trusted the company upon the faith of that increased stock; but the fact that the capital stock had been increased to \$200,000 was made public and was generally known." The real question in this connection is, "When may it be presumed creditors trusted the corporation upon the faith of the increased stock? Obviously, when such increase was ordered. That is a fact to which publicity would naturally be given; the creditors could not be expected to know when and by whom such stock would be taken. It is true they assume the risk of the stock not being taken at all, but the moment shares are taken, they are supposed to represent so much money put into the treasury as they are worth, which becomes available for the payment, not only of future, but of existing, creditors. It is manifest that any attempt to gauge the liability of stockholders by the exact time they took their stock with reference to the dates when the several claims of the creditors accrued, and by the further fact whether the creditors actually knew of and relied upon such stock, would in case like this, where the creditors and stockholders are both numerous, lead into inextricable confusion. Even the flexibility of a court of equity would be inadequate to adjust the rights of the parties.

7. With regard to the special defense set up by Neely, that he never consented to nor received certificates for increased stock, we agree with the circuit judge that it is not sustained. He did not live in Nashville, but had given a proxy to one Sandford to represent him at stockholders' meetings; he knew of the arrangement to issue an amount of stock equal to the bonds, and to distribute \$30,000 of the increased stock, ordered by the resolution of May, 1886; and on April 5, 1887, he gave a power of attorney to Sandford, authorizing the latter, for him, and in his name and stead to "receipt to the Clifton Coal Company for stock in my name, and transfer, bargain and sell the same as if I were there present." Under this power of attorney, Sandford surrendered Neely's certificate for 300 shares, and receipted for 375 shares, the certificates for which were delivered to him as agent of Neely, and which Sandford subsequently voted at stockholders' meetings, under the general proxy from Neely to represent his stock. Knowing of the contemplated action in issuing the new stock, and having authorized Sandford to represent him in all matters connected therewith, we think it too late for him to repudiate Sandford's act in receiving the additional 75 shares, which were distributed to him as the owner of 300 original shares. Indeed the circuit judge finds it to be established by the proof that all of the old stockholders knew of and acquiesced in the disposition of the new stock as made; and that such increased stock was represented and voted at subsequent meetings of stockholders, and was recognized and held out to be public as part of

the capital stock of the company. \* Under the case of *Sawyer v. Hoag*, 84 U. S. 17 Wall, 610. Neely was clearly not entitled to set-off against the claim of the creditors his own claim against the corporation. Cook on Stock and Stockholder, secs. 193 and 194.

There are several minor points made in the briefs of counsel with regard to the claims of certain creditors which we do not find it necessary to discuss at length. We think there was no error in the rulings of the court in these particulars.

It results that the decree of the court below must be reversed and the cause remanded for further proceedings in conformity with this opinion.

Mr. Chief Justice Fuller, with whom concurring Mr. Justice Lamar, dissenting:

I dissent from the conclusion of the court in respect of the stock received by the subscribers to the bonds. That stock was not paid for in money or money's worth, or issued in payment of debts due from the company, or purchased at sale upon the market. It was a mere bonus, thrown in with the bonds as furnishing the inducement to the bond subscription, of larger control over the corporation, and of possible gain without expenditure. Becoming secured creditors through the bonds, the subscribers increased their power through the stock. In my view, there was no actual payment for the stock, and to treat it as paid up is to sanction an arrangement to relieve those who could reap the benefit derived from the possession of the stock, in the event of the success, from liability for the consequences, in the event of the failure, of the enterprise.

When the capital stock of a corporation has become impaired, or the business in which it has engaged has proven so unremunerative as to call for a change, creditors at large may well demand that experiments at rehabilitation should not be conducted at their risk.

My brother Lamar concurs with me in this dissent.

## COIT V. GOLD AMALGAMATING CO.

SUPREME COURT OF THE UNITED STATES, 1886.

(119 U. S. 342.)

*Shares Issued in Consideration of Property.*

Mr. Justice Field: The defendant, the North Carolina Gold Amalgamating Company, was incorporated under the laws of North Carolina on the 30th of January, 1874, for the purpose, among other things, of working, milling, smelting, reducing and assaying ores and metals, with the power to purchase such property, real and personal, as might be necessary in its business, and to mortgage or sell the same.

The plaintiff is the holder of a judgment against the company for \$5,489, recovered in the Court of Common Pleas of Philadelphia, on the 18th of May, 1879, upon its two drafts, one dated June 1, 1874, and the other August 15, 1874, each payable four months after its date. Unable to obtain satisfaction of this judgment upon execution, and finding that the company was insolvent, the plaintiff brought this suit to compel the stockholders to pay what he claims to be due and unpaid on the shares of the capital stock held by them, alleging that he had frequently applied to the officers of the company to institute a suit for that purpose, but that under various pretenses they refused to take any action in the premises.

By its charter the minimum capital stock was fixed at \$100,000, divided into 1,000 shares of \$100 each, with power to increase it from time to time, by a majority vote of the stockholders, to two million and a half of dollars. The charter provided that the subscription to the capital stock might be paid "in such installments, in such manner and in such property, real and personal," as a majority of the corporators might determine, and that the stockholders should not be liable for any loss or damages, or be responsible beyond the assets of the Company.

Previously to the charter the corporators had been engaged in mining operations, conducting their business under the name and title which they took as a corporation. Upon obtaining the char-



ter the capital stock was paid by the property of the former association, which was estimated to be of the value of \$100,000, the shares being divided among the stockholders in proportion to their respective interests in the property. Each stockholder placed his estimate upon the property, and the average estimate amounted to \$137,500. This sum they reduced to \$100,000, inasmuch as the capital stock was to be of that amount.

The plaintiff contends, and it is the principal basis of his suit, that the valuation thus put upon the property was illegally and fraudulently made at an amount far above its actual value, averring that the property consisted only of a machine for crushing ores, the right to use a patent called the Crosby process, and the charter of the proposed organization; that the articles had no market or actual value, and, therefore, that the capital stock issued thereon was not fully paid, or paid to any substantial extent, and that the holders thereof were still liable to the corporation and its creditors for the unpaid subscription.

If it were proved that actual fraud was committed in the payment of the stock, and that the complainant had given credit to the company from a belief that its stock was fully paid, there would undoubtedly be substantial ground for the relief asked. But where the charter authorizes capital stock to be paid in property, and the shareholders honestly and in good faith put in property instead of money, in payment of their subscriptions, third parties have no ground of complaint. The case is very different from that in which subscriptions to stock are payable in cash, and where only a part of the installments has been paid. In that case there is still a debt due to the corporation, which, if it become insolvent, may be sequestered in equity by the creditors, as a trust fund liable to the payment of their debts. But where full-paid stock is issued for property received there must be actual fraud in the transaction to enable creditors of the corporation to call the stockholders to account. A gross and obvious overvaluation of property would be strong evidence of fraud. *Boynton v. Hatch*, 47 N. Y. 225; *Van Cott v. Van Brunt*, 82 N. Y. 535; *Carr v. LeFevre*, 27 Pa. St. 413.

But the allegation of intentional and fraudulent overvaluation of the property is not sustained by the evidence. The patent and the machinery had been used by the incorporators in their business, which was continued under the charter. They were immediately serviceable, and therefore had to the company a present value. The incorporators may have placed too high an estimate upon the property, but the court below finds that its valuation was honestly and fairly made; and there is only one item, the value of the chartered privileges, which is at all liable to any legal objection.

But if that were deducted, the remaining amount would be so near to the aggregate capital that no implication could be raised against the entire good faith of the parties in the transaction.

In May, 1874, the company increased its stock, as it was authorized to do by its charter, to \$1,000,000, or 10,000 shares of \$100 each. This increase was made pursuant to an agreement with one Howes, by which the company was to give him 2,000 shares of the increased stock for certain lands purchased from him. Of the balance of the increased shares 4,000 were divided among the holders of the original stock upon the return and delivery to the company of the original certificates, — they thus receiving four shares of the increased capital stock for one of the original shares returned. The other 4,000 shares were retained by the company. The land purchased was subject to three mortgages, of which the plaintiff held the third; and the agreement was that, under the first mortgage, a sale should be made of the property, and that mortgages for a like amount should be given to the parties according to their several and respective amounts, and in their respective positions and priorities.

The plaintiff was to be placed by the Company, after the release of his mortgage, in the same position. Accordingly he made a deed to it of all his interest and title under the mortgage held by him, the trustee joining with him, in which deed the agreement was recited. The company thereupon gave him its mortgage upon the same and other property, which was payable in installments. The plaintiff also received at the same time an accepted draft of Howes' on the company for \$1,000. When the first installment on the mortgage became due, the company being unable to pay it, he took its draft for the amount, \$3,000, payable in December following. It is upon these drafts that the judgment was recovered in the Court of Common Pleas of Philadelphia, which is the foundation of the present suit. It is in evidence that the plaintiff was fully aware, at the time, of the increase in the stock of the company, and of its object. Six months afterwards the increase was canceled, the outstanding shares were called in, and the capital stock reduced to its original limit of \$100,000. Nothing was done after the increase to enlarge the liabilities of the Company. The draft of Howes was passed to the plaintiff and received by him at the time the agreement was carried out upon which the increase of the stock was made, and the draft for \$3,000 was for an installment upon the mortgage then executed. The plaintiff had placed no reliance upon the supposed paid-up capital of the company on the increased shares, and therefore has no cause of complaint by reason of their subsequent recall. Had a new indebtedness been created by the company after the issue

of the stock and before its recall, a different question would have arisen. The creditor in that case, relying on the faith of the stock being fully paid, might have insisted upon its full payment. But no such new indebtedness was created, and we think, therefore, that the stockholders cannot be called upon, at the suit of the plaintiff, to pay in the amount of the stock, which, though issued, was soon afterwards recalled and canceled.

Judgment affirmed.

## CHAPTER XII.

## STATUTORY LIABILITY.

## FIRST NATIONAL BANK V. GUSTIN MINERVA CONSOLIDATED MINING CO.

SUPREME COURT OF MINNESOTA, 1890.

(42 Minn. 327.)

*Liability of Non-resident Stockholders.*

MITCHELL, J.: This action was brought upon a debt of the defendant company, a corporation organized under the laws of Dakota territory, and against the other defendants, citizens of this state, as stockholders, to obtain judgment against the company for the amount of the debt, and against the other defendants for the respective amounts alleged to be due and unpaid on the stock held by them, so far as necessary to satisfy the judgment against the corporation. To dispose of certain preliminary questions raised by the defendants, it may be stated at the outset that it is elementary law that, where a person becomes a stockholder in a corporation organized under the laws of a foreign state, he must be held to contract with reference to all of the laws of the state under which the corporation is organized and which enter into its constitution; and the extent of his individual liability as a shareholder to the creditors of the company must be determined by the laws of that state, not because such laws are in force in this state, but because he has voluntarily agreed to the terms of the company's constitution. It is equally clear, upon both principle and authority, that this liability may be enforced by creditors wherever they can obtain jurisdiction of the necessary parties. This does not depend upon any principle of comity, but upon the right to enforce in another jurisdiction a contract validly entered into. The remedy, however, does not enter into the contract itself; and for this reason the individual liability of shareholders can only be enforced by the remedies provided by the laws of the *forum*. Hence the question of the liability of the defendant shareholders must be determined by the laws of Dakota, and that of remedy by the laws of Minnesota.

That the remedy resorted to by plaintiff in this case is a proper one is well settled. *Merchants' Nat. Bank v. Bailey Mfg. Co.*, 34 Minn. 323, (25 N. W. Rep. 639). Upon the trial the judge considered it to be one triable by the court, but, on his own motion, submitted a specific question of fact to a jury; but subsequently, considering the verdict as immaterial, he proceeded without regard to it, and found the facts upon all the issues in the case. As neither party claims anything from this special finding of the jury, and as there is no exception which raises the question whether the action was triable by the court or by a jury, the whole case is reduced to the single question whether the conclusions of law are justified by the findings of fact.

Section 413 of the Civil Code of Dakota provides that "each stockholder of a corporation is individually and personally liable for the debts of the corporation to the extent of the amount that is unpaid upon the stock held by him." This is but declaratory of the common law.

The findings of fact, so far as here material, are, in substance, as follows: Prior to November 13, 1886, there had been organized, and were at that date in existence, under the laws of Dakota, two mining corporations, viz., the Gustin Belt Gold Mining Company, and the Minerva Mining Company, of the latter of which the plaintiff, a national banking association of Deadwood, Dak., was a creditor. On the date named the defendant corporation was organized for the purpose and with intention of consolidating the other two companies, acquiring their property, and with the property so acquired carrying on a general mining business. "At the time of the organization of the defendant company, and as the scheme on which the same was based, it was agreed by the parties so incorporating, and by those representing and having authority to act for the two existing companies, that all the mines and mining property of such two corporations should, upon its organization, be transferred and conveyed to the new, or defendant, company, and constitute its entire capital stock and resources for the prosecution of its enterprise, and be represented in such organization by a nominal capital stock of \$2,500,000, divided into 250,000 shares, of \$10 each, which should all be deemed and held as represented by the properties so conveyed to it; that 50,000 of said shares should be issued to the former shareholders of each of the two old companies, and the remaining 150,000 shares belong to and constitute the working capital of the new corporation, and be sold under its authority, and on such terms as it should direct; and the proceeds of such sales constitute a fund to pay off the debts on the properties, and develop the mines thereon, and be used generally in the prosecution of the business of the new corporation, for the benefit of all its stock-

holders. That it was never expected or intended by such corporation, or by those to whom its stock was issued, that any subscription to the capital stock of the new company should ever be made, or that any capital stock should ever be taken, or any capital subscribed for or paid in, except by conveyance to it of the mining properties referred to, and the sale of the stock reserved for its working capital, in open market, for such sum as could be obtained therefor." This scheme was carried into effect by the conveyance to the new or defendant corporation of the properties of the two old corporations, and the issue to their stockholders, according to their respective holdings, of 100,000 shares of the stock of the new company (called in the findings "Old Company Stock") as paid-up stock, and by placing the remaining 150,000 in charge of the board of directors, to be by them sold in the open market for such price per share (not less than 50 cents) as could be obtained therefor. The mining properties of the two old companies conveyed to the new company were not worth to exceed \$50,000 cost, and were at the time of this scheme of consolidation considered and estimated as of the aggregate value of \$100,000. The new and defendant company assumed payment of the indebtedness of the Minerva Mining Company to the plaintiff, which consented to a novation of its debt, accepting the notes of the defendant company in place of those of the old Minerva Company. *This is the claim upon which this action is brought.* The court also finds "that the payees in said notes named, and the general managing officer of the plaintiff, well knew, at the time of the execution of said notes and of their indorsement and delivery to the plaintiff, all the facts hereinbefore stated, relating to the organization of the defendant corporation and the understanding and plan of its organization, and so dealt with the defendant knowing such matters, and were parties to and interested in the original scheme of the incorporation of the defendant company as in the findings set forth." This must be construed as meaning that the "general managing officer" referred to is the person who transacted the business with the defendant company in taking these notes, and of the benefit of whose action in that regard the plaintiff has availed itself. Notice to him must be deemed notice to the plaintiff.

Returning, now, to the subsequent management of the affairs of the defendant company, the board of directors, pursuant to the scheme of organization, offered for sale in the open market the 150,000 shares remaining in the treasury, as fully paid-up stock, and some of it was bought as such by the other defendants in good faith, for a price exceeding its fair market value, (but not exceeding one dollar per share,) believing it to be fully paid-up stock. This is called in the findings "Treasury Stock." The

holders of the old company stock also placed their stock in the market, some of which the defendants also bought, under like circumstances and in the same belief. In March, 1887, the board of directors, pursuant to a resolution adopted by them, distributed *pro rata* among the individual shareholders all the stock remaining unsold in the treasury. Of this the individual defendants received their respective shares, for which they paid nothing. This is called in the findings "Pro rate Stock." The court also finds that none of such defendants ever contracted, promised, or in any manner agreed, or intended to contract, promise, or agree, to pay, on account of such stock, any other or different or greater sum or consideration, unless the law would impose or imply such promise, contract, or agreement from the foregoing facts. The holdings of the defendants consist, in part, of old company stock, in part of treasury stock, and in part of pro rate stock.

The contention of the plaintiff is that the defendant shareholders are individually liable, as for unpaid stock subscriptions, for amounts equal to the amount of their stock, less the value of what they have actually paid therefor, viz., nine dollars per share on the old company and treasury stock, for which they paid in value only one dollar per share, and ten dollars per share on the pro rate stock, for which they paid nothing. If these stockholders were indebted to the corporation for unpaid instalments on stock, this debt would be an asset of the corporation which, in case it became insolvent, any creditor might always enforce for the purpose of satisfying his claim. But it is very clear from the facts that the defendant company has no claim against the defendant stockholders. They owe it nothing. As between them and it, the arrangement by which this stock was issued and sold, or given away, as fully paid stock, is entirely valid. But the plaintiff bases its claim upon the familiar doctrine that the capital stock of a corporation is a trust fund for the benefit of its creditors, and that, if shares are not in fact paid up, an arrangement between the corporation and the shareholders that they shall be deemed paid up, although valid between the company and the stockholder, will be ineffectual as to creditors, and that equity will hold the shareholder liable for the amount not in fact paid on his stock, to the extent necessary to satisfy the demands of creditors. We waive consideration of the question (which may, at least, admit of doubt) whether plaintiff's complaint is sufficient to entitle it to such relief. See *Phelan v. Hazard*, 5 Dill. 45; *Cook, Stocks*, § 47; *Scovill v. Thayer*, 105 U. S. 143.

The general proposition advanced by plaintiff cannot be controverted, but the principle upon which this trust in favor of creditors rests and is administered must not be overlooked. The whole doctrine that the capital stock of corporations is a trust fund for

the payment of creditors rests upon the equitable consideration that the distribution of the capital among stockholders without making adequate provision for the payment of debts, or the issue of fictitiously paid-up stock, is a fraud upon creditors who contract with the corporation in reliance upon its capital remaining intact, or in reliance upon the professed capital having been in fact paid up in full. But when the reason for the rule does not exist the rule itself ceases to apply. This trust does not arise absolutely in every case, in favor of every and any creditor. It is not true, and no case can be found which holds, that it is in the power of a creditor in every and all cases, as a matter of right, to institute an inquiry as to the value or amount of the consideration given for stock issued as fully paid up, any more than that it would be his right, in any and every case, to inquire into the distribution of the capital among the shareholders. It is only those creditors who can fairly allege that they have relied, or whom the law presumes to have relied, upon the amount of capital stock of the company, who have a right to make such inquiry, or in whose favor equity will impress a trust upon the subscription to the stock, and set aside a fictitious arrangement for its payment. For example, to distribute the capital among the shareholders without provision for paying corporate debts would be a fraud on existing creditors, as well as on such subsequent creditors as deal with the corporation in reliance upon the assumption that its professed capital remains intact. An illustration of this kind is to be found in the very first case in which what is now called the "American doctrine" was announced by Justice Story. We refer to the case of *Wood v. Dummer*, 3 Mason, 308, where a banking association distributed three-fourths of its capital among its shareholders without providing for the payment of billholders, and the court impressed a trust in their favor upon the capital in the hands of the shareholders. So, again, where corporations have organized and engaged in business with a certain amount of ostensible and professed paid-up capital, but which was not in fact paid in, there are numerous cases in which the courts have set aside the arrangement by which the stock was called "paid-up," and impressed a trust upon the subscription of the shareholder in favor of subsequent creditors who relied upon, or whom the law would presume to have relied upon, the apparent and professed amount of capital. To this class belong many of the cases cited by plaintiff, as for example, *Sawyer v. Hoag*, 17 Wall. 610; *Wetherbee v. Baker*, 35 N. J. Eq. 501.

While the courts have not always had occasion to state the limitations upon the doctrine that "the capital is a trust fund for the benefit of creditors," yet we think that it will be found that in every case where they have impressed a trust upon the sub-



scription of the shareholders, it has been in favor of creditors becoming such afterwards, and hence fairly to be presumed as relying upon the amount of capital which the company was represented as having. We are referred to none, and have found none, where any such trust has been enforced in favor of creditors who have dealt with the corporation with full knowledge of the facts. The reason is apparent, for in such cases no fraud, actual or constructive, has been committed on such creditors. If a corporation issue new shares after the claim of a creditor arose, it is clear that the latter could not have dealt with the company on the faith of any capital represented by them. Whatever was contributed as capital in respect of the new shares was a clear gain to the creditor's security. So, too, if a party deals with a corporation with full knowledge of the fact that its nominal paid-up capital has not in fact been paid for in money or property to the full amount of its par value, he deals solely on the faith of what has been actually paid in, and has no equitable right to insist on the contribution of a greater amount of capital by the shareholders than the corporation itself could claim as part of its assets. *Coit v. Gold Amalgamating Co.*, 14 Fed. Rep. 12, same case 119 U. S. 343 (7 Sup. Ct. Rep. 231). This doctrine with respect to trusts has no application to a case where a party, like the plaintiff, was cognizant of the whole arrangement under which the stock of the defendant company was issued, and of what was paid or intended to be paid for it, and who accepted a novation of its debt with full knowledge of these facts, and received as great or greater security for it than it had before. To hold otherwise would be to perpetrate a fraud on the stockholders, and not on the creditors.

These views effectually dispose of the question of the liability of the defendants, at least on account of their old company and treasury stock. We think it also logically follows from what we have said that the defendants are not liable to the plaintiff upon their "pro rate" stock as for unpaid stock subscriptions. This stock had not been issued when plaintiff's debt was contracted. It could not have dealt with the company on the faith of any capital represented by these shares. In fact, it knew that no such capital had been paid in, unless the mining properties of the two old companies can be considered as represented in part by them; and the value of these properties remained the same, and they were equally available to creditors, whether represented by 100,000 shares or 250,000 shares of stock. Under such circumstances, the plaintiff has no equitable right to insist on the contribution of a greater amount of capital by the holders of these shares than the corporation itself could insist on. 2 Mor. Priv. Corp., §§ 832, 833.

Judgment affirmed.

## HUNTINGTON V. ATTRILL.

SUPREME COURT OF THE UNITED STATES, 1892.

(146 U. S. 657.)

*Enforcement of Penal Liability.*

Mr. Justice Gray: This was a bill in equity, filed March 21, 1888, in the circuit court of Baltimore city, by Collis P. Huntington, a resident of New York, against the Equitable Gas Light Company of Baltimore, a corporation of Maryland, and against Henry Y. Attrill, his wife and three daughters, all residents of Canada, to set aside a transfer of stock in that company, made by him for their benefit and in fraud of his creditors, and to charge that stock with the payment of a judgment recovered by the plaintiff against him in the state of New York upon his liability as a director in a New York corporation, under the statute of New York of 1875, c. 611, the material provisions of which are copied in the margin.\* The bill alleged that on June 15th, 1866, the plaintiff recovered, in the supreme court of the state of New York, in an action brought by him against Attrill on March 21, 1883, a judgment for the sum of \$100,240, which had not been paid, secured or satisfied; and that the cause of action on which that judgment was recovered was as follows: On February 29, 1880, the Rockaway Beach Improvement Company, limited, of which Attrill was an incorporator and a director, became a corporation under the law of New York, with a capital stock of \$700,000. On June 15, 1880, the plaintiff lent that company the sum of \$100,000, to be repaid on demand. On February 26, 1880, Attrill was elected one of the directors of the company and accepted the office, and continued to act as a director until after January 29, 1881. On June 30, 1880, Attrill, as a director of the company, signed and made oath to, and caused to be recorded, as required by the law of New York, a certificate, which he knew to be false, stating that the whole of the capital stock of the corporation had been paid in, whereas in truth no part had been paid

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\*Sec. 21. If any certificate or report made, or public notice given, by the officers of any such corporation, shall be false in any material representation, all the officers who shall have signed the same shall be jointly and severally liable for all the debts of the corporation contracted while they are officers thereof.

Sec. 37. In limited liability companies, all the stockholders shall be severally individually liable to the creditors of the company in which they are stockholders to an amount equal to the amount of stock held by them respectively, for all debts and contracts made

in, and by making such false certificate became liable, by the law of New York, for all the debts of the company contracted before January 29, 1881, including its debt to the plaintiff. On March 8, 1882, by proceedings in a court of New York, the corporation was declared to be insolvent and to have been so since July, 1880, and was dissolved. A duly exemplified copy of the record of that judgment was annexed to and made part of the bill.

The bill also alleged that "at the time of its dissolution as aforesaid, the said company was indebted to the plaintiff and to other creditors to an amount far in excess of its assets; that by the law of the state of New York all the stockholders of the company were liable to pay all its debts, each to the amount of the stock held by him, and the defendant, Henry Y. Attrill, was liable at said date and on April 14, 1882, as such stockholder, to the amount of \$340,000, the amount of stock held by him, and was on both dates also severally and directly liable as a director, having signed the false report above mentioned, for all the debts of said company contracted between February 26, 1880, and January 29, 1881, which debts aggregate more than the whole value of the property owned by said Attrill."

The bill further alleged that Attrill was in March, 1882, and had ever since remained individually liable in a large amount over and above the debts for which he was liable as a stockholder and director in the company, and that he was insolvent, and had secreted and concealed all his property for the purpose of defrauding his creditors.

The bill then alleged that in April, 1882, Attrill acquired a large amount of stock in the Equitable Gas Light Company, of Baltimore, and forthwith transferred into his own name as trustee for his wife 1,000 shares of such stock, and as trustee for each of his three daughters, 250 shares of the same, without valuable consideration, and with intent to delay, hinder and defraud his creditors, and especially with the intent to delay, hinder and defraud this plaintiff of his lawful suits, damages, debts and demands against Attrill, arising out of the cause of action on which the aforesaid judgment was recovered, and out of the plaintiff's claim against him as a stockholder; that the plaintiff in June, 1880,

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by such company, until the whole amount of capital stock fixed and limited by such company has been paid in, and a certificate thereof has been made and recorded as herein-after prescribed. . . . The capital stock of every such limited liability company shall be paid in, one-half thereof within one year and the other half thereof within two years from the incorporation of said company, or such corporation shall be dissolved. The directors of every such company, within thirty days after payment of the last instalment of the capital stock, shall make a certificate stating the amount of the capital so paid in, which certificate shall be signed and sworn to by the president and a majority of the directors; and they shall, within the said thirty days, record the same in the office of the secretary of state, and of the county in which the principal business office of such corporation is situated.

Sec. 88. The dissolution for any cause whatever of any corporation created as aforesaid shall not take away or impair any remedy given against such corporation, its stockholders or officers, for any liabilities incurred previous to its dissolution.

and ever since was domiciled and resident in the state of New York; and that from February, 1880, to December 6, 1884, Attrill was domiciled and resident in that state; and that his transfers of stock in the gas company were made in the city of New York, where the principal office of the company then was, and where all its transfers of stock were made; and that those transfers were, by the laws of New York, as well as by those of Maryland, fraudulent and void as against the creditors of Attrill, including the creditors of the Rockaway Company, and were fraudulent and void as against the plaintiff.

The bill further, by distinct allegations, averred that those transfers, unless set aside and annulled by a court of equity, would deprive the plaintiff of all his rights and interests of every sort therein, to which he was entitled as a creditor of Attrill at the time when those fraudulent transfers were made; and "that the said fraudulent transfers were wholly without legal consideration, were fraudulent and void, and should be set aside by a court of equity."

The bill prayed that the transfer of shares in the gas company be declared fraudulent and void and executed for the purpose of defrauding the plaintiff out of his claim as existing creditor; that the certificates of those shares in the name of Attrill, as trustee, be ordered to be brought into court and cancelled; and that the shares "be decreed to be subject to the claim of this plaintiff on the judgment aforesaid," and to be sold by a trustee appointed by the court and new certificates issued by the gas company to the purchasers, and for further relief.

One of the daughters demurred to the bill because it showed that the plaintiff's claim was for the recovery of a penalty against Attrill arising under a statute of the state of New York, and because it did not state a case which entitled the plaintiff to any relief in a court of equity in the state of Maryland.

By a stipulation of counsel, filed in the cause, it was agreed that, for the purpose of the demurrer, the bill should be treated as embodying the New York statute of June 31, 1875, and that the Rockaway Beach Improvement Company, limited, was incorporated under the provisions of that statute.

The circuit court of Baltimore city overruled the demurrer. On appeal to the court of Appeals of the state of Maryland the order was reversed and the bill dismissed. 70 Maryland, 191.

The ground most prominently brought forward and most fully discussed in the opinion of the majority of the court, delivered by Judge Bryan, was that the liability imposed by section 21 of the statute of New York upon officers of a corporation making a false certificate of its condition was for all its debts, without inquiring whether a creditor had been deceived and induced by deception to

lend his money or to give credit, or whether he had incurred loss to any extent by the inability of the corporation to pay, and without limiting the recovery to the amount of loss sustained, and was intended as a punishment for doing of any of the forbidden acts, and was, therefore, in view of the decisions in that state and in Maryland, a penalty which could not be enforced in the state of Maryland; and that the judgment obtained in New York for this penalty, while it "merged the original cause of action so that a suit cannot be again maintained upon it," and "is also conclusive evidence of its existence in the form and under the circumstances stated in the pleadings," yet did not change the nature of the transaction, but, within the decision of this court in *Wisconsin v. Pelican Ins. Co.*, 127 U. S. 265, was in it "essential nature and real foundation" the same as the original cause of action, and therefore, a suit could not be maintained upon such a judgment beyond the limits of the state in which it was rendered. Pp. 193-198.

The court then took up the clause of the bill above quoted, in which it was sought to charge Attrill as originally liable under the statute of New York, both as a stockholder and as a director; and observing that "this liability is asserted to exist independently of the judgment," summarily disposed of it, upon the grounds that it could not attach to him as a stockholder, because he had not been sued, as required by the New York statute, within two years after the plaintiff's debt became due; nor as a director, because "the judgment against Attrill for having made the false report certainly merges all right of action against him on this account;" but that, if he was liable at the time and on the grounds "mentioned in this clause of the bill," this liability was barred by the statute of limitations of Maryland, pp. 198, 199.

Having thus decided against the plaintiff's claim under his judgment upon the single ground that it was for a penalty under the statute of New York, and, therefore, could not be enforced in Maryland, and against any original liability under the statute, for various reasons, the opinion concluded: "Upon the whole, it appears to us that the complainant has no cause of action, which he can maintain in this state." P. 199.

Judge Stone, with whom Judge McSherry concurred, dissented from the opinion of the court, upon the ground that it did not give due effect to the act of congress, passed in pursuance of the Constitution of the United States, and providing that the records of judgments rendered by a court of any State shall have such faith and credit given to them in every court within the United States as they have by law or usage in the courts of the State whence they are taken. Act of May 26, 1790, c. 11, 1 Stat. 122; Rev. Stat. § 905. He began his opinion by saying: "I look upon

the principal point as a Federal question, and am governed in my views more by my understanding of the decisions of the Supreme Court of the United States than by the decisions of the state courts." And he concluded thus: "I think the Supreme Court, in 127 U.S., meant to confine the operation of the rule that no country will execute the penal laws of another to such laws as are properly classed as criminal. It is not very easy to give any brief definition of a criminal law. It may, perhaps, be enough to say that, in general, all breaches of duty that confer no rights upon an individual or person, and which the State alone can take cognizance of, are in their nature criminal, and that all such come within the rule. But laws which, while imposing a duty, at the same time confer a right upon the citizen to claim damages for its nonperformance, are not criminal. If all the laws of the latter description are held penal in the sense of criminal, that clause in the Constitution which relates to records and judgments is of comparatively little value. There is a large and constantly increasing number of cases that may in one sense be termed penal, but can in no sense be classed as criminal. Examples of these may be found in suits for damages for negligence in causing death, for double damages for the injury to stock where railroads have neglected the state laws for fencing in their tracks, and the liability of officers of corporations for the debts of the company, by reason of their neglect of a plain duty imposed by statute. I cannot think that judgments on such claims are not within the protection given by the Constitution of the United States. I, therefore, think the order in this case should be affirmed." pp. 200-205.

A writ of error was sued out by the plaintiff and allowed by the Chief Justice of the Court of Appeals of Maryland upon the ground "that the said Court of Appeals is the highest court of law or equity in the State of Maryland in which a decision in the said suit could be had; that in said suit a right and privilege are claimed under the Constitution and statutes of the United States, and the decision is against the right and privilege set up and claimed by your petitioner under said Constitution and statutes; and that in said suit there is drawn in question the validity of a statute of and an authority exercised under the United States, and the decision is against the validity of such statute and of such authority."

It thus appears that the judgment recovered in New York was made the foremost ground of the bill, was fully discussed and distinctly passed upon by the majority of the Court of Appeals of Maryland, and was the only subject of the dissenting opinion; and that the court, without considering whether the validity of the transfers impeached as fraudulent was to be governed by the law of New York or by the law of Maryland, and without a sug-

gestion that those transfers, alleged to have been made by Attrill with intent to delay, hinder and defraud all his creditors, were not voidable by subsequent, as well as existing creditors, or by that they could not be avoided by the plaintiff claiming under the judgment recovered by him against Attrill after those transfers were made, declined to maintain his right to do so by virtue of that judgment, simply because the judgment had, as the court held, been recovered in another State in an action for a penalty.

The question whether due faith and credit were thereby denied to the judgment rendered in another State is a Federal question, of which this court has jurisdiction on this writ of error. *Green v. Van Buskirk*, 5 Wall. 307, 311; *Crapo v. Kelly*, 16 Wall. 610, 619; *Dupasseur v. Rochereau*, 21 Wall. 130, 134; *Crescent City Co. v. Butchers' Union*, 120 U. S. 141, 146, 147; *Cole v. Cunningham*, 133 U. S. 107; *Carpenter v. Strange*, 141 U. S. 87, 103.

In order to determine this question it will be necessary, in the first place, to consider the true scope and meaning of the fundamental maxim of international law, states by Chief Justice Marshall in the fewest possible words: "The courts of no country execute the penal laws of another." *The Antelope*, 10 Wheaton, 66, 123. In interpreting this maxim there is danger of being misled by the different shades of meaning allowed to the word "penal" in our language.

In the municipal law of England and America the words "penal" and "penalty" have been used in various senses. Strictly and primarily they denote punishment, whether corporal or pecuniary, imposed and enforced by the state for a crime or offence against its laws. *United States v. Reisinger*, 128 U. S. 398, 402; *United States v. Chouteau*, 102 U. S. 603, 611. But they are also commonly used as including any extraordinary liability to which the law subjects a wrong doer in favor of the person wronged, not limited to the damages suffered. They are so elastic in meaning as even to be familiarly applied to cases of private contracts, wholly independent of statutes, as when we speak of the "penal sum," or "penalty" of a bond. In the words of Chief Justice Marshall: "In general, a sum of money in gross, to be paid for the nonperformance of an agreement, is considered as a penalty, the legal operation of which is to cover the damages which the party in whose favor the stipulation is made may have sustained from the breach of contract by the opposite party." *Taylor v. Sandiford*, 7 Wheat. 13, 17.

Penal laws, strictly and properly, are those imposing punishment for an offence committed against the state, and which, by the English and American constitutions, the executive of the state has the power to pardon. Statutes giving a private action against the wrongdoer are sometimes spoken of as penal in their

nature, but in such cases it has been pointed out that neither the liability imposed nor the remedy given is strictly penal.

The action of an owner of property against the hundred to recover damages caused by a mob was said by Justices Willes and Buller to be "penal against the hundred, but certainly remedial as to the sufferer."

*Hyde v. Cogan*, 2 Doug. 699, 705, 706. A statute giving the right to recover back money lost at gaming, and if the loser does not sue within a certain time, authorizing a *qui tam* action to be brought by any other person for threefold the amount, has been held to be remedial as to the loser, though penal as regards the suit by a common informer. *Bones v. Booth*, 2 W. Bl. 1226; *Brandon v. Pate*, 2 H. Bl. 308; *Grace v. McElroy*, 1 Allen, 563; *Read v. Stewart*, 129 Mass. 407, 410; *Cole v. Groves*, 134 Mass. 471. Assaid by Mr. Justice Ashhurst in the King's Bench, and repeated by Mr. Justice Wilde in Supreme Judicial Court of Massachusetts, "it has been held in many instances that where a statute gives accumulative damages to the party grieved it is not a penal action." *Woodgate v. Knatchbull*, 2 T. R. 148, 154; *Read v. Chelmsford*, 16 Pick. 128, 132. Thus a statute giving to a tenant ousted without notice double the yearly value of the premises against the landlord has been held to be "not like a penal law where a punishment is imposed for a crime," but "rather as a remedial than a penal law," because "the act in deed does give a penalty, but it is to the party grieved." *Lake v. Smith*, 1 Bos. & Pul. (N. P.) 174, 179, 180, 181; *Wilkinson v. Colley*, 5 Burrow, 2694, 2698. So in an action given by statute to a traveller injured through a defect in a highway for double damages against the town it was held unnecessary to aver that the facts constituted an offence, or to conclude against the form of the statute, because, as Chief Justice Shaw said: "The action is purely remedial, and has none of the characteristics of a penal prosecution. All damages for neglect or breach of duty operate to a certain extent as punishment, but the distinction is that it is prosecuted for the purpose of punishment and to deter others from offending in a like manner. Here the plaintiff sets out the liabilities of the town to repair and an injury to himself from a failure to perform that duty. The law gives him enhanced damages, but still they are recoverable to his own use, and in form and substance the suit calls for indemnity." *Reed v. Northfield*, 13 Pick. 94, 100, 101.

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The provision of the statute of New York, now in question, making the officers of a corporation who sign and record a false certificate of the amount of its capital stock, liable for all its debts



is in no sense a criminal or *quasi* criminal law. The statute, while it enables persons complying with its provisions to do business as a corporation, without being subject to the liability of general partners, takes pains to secure and maintain a proper corporate fund for the payment of the corporate debts. With this aim it makes the stockholders individually liable for the debts of the corporation until the capital stock is paid in and a certificate of the payment made by the officers, and makes the officers liable for any false and material representation in that certificate. The individual liability of the stockholders takes the place of a corporate fund until that fund has been duly created, and the individual liability of the officers takes the place of the fund in case their statement that it has been duly created is false. If the officers do not truly state and record the facts which exempt them from liability they are made liable directly to every creditor of the company, who by reason of their wrongful acts has not the security for the payment of his debt out of the corporate property, on which he had a right to rely. As the statute imposes a burdensome liability on the officers for their wrongful act, it may well be considered penal, in the sense that it should be strictly construed. But as it gives a civil remedy at the private suit of the creditor only, and measured by the amount of his debt it is as to him clearly remedial. To maintain such a suit is not to administer a punishment imposed upon an offender against the State, but simply to enforce a private right secured under its laws to an individual. We can see no just ground, on principle, for holding such a statute to be a penal law, in the sense that it can not be enforced in a foreign state or country.

The decisions of a Court of Appeals of New York, so far as they have been brought to our notice, fall short of holding that the liability imposed upon the officers of the corporation by such statutes is a punishment or penalty which cannot be enforced in another State.

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It is true that the courts of some States, including Maryland, have declined to enforce a similar liability imposed by the statute of another State. But in each of these cases it appears to have been assumed to be a sufficient ground for that conclusion, that the liability was not founded in contract, but was in the nature of a penalty imposed by statute, and no reasons were given for considering the statute a penal law in the strict, primary and international sense. *Derrickson v. Smith*, 3 Dutcher (27 N. J. Law), 166; *Halsey v. McLean*, 12 Allen, 438; *First National Bank v. Price*, 33 Maryland, 487.

It is also true that in *Steam Engine Co. v. Hubbard*, 101 U. S. 188, 192, Mr. Justice Clifford referred to those cases by way of argument. But in that case, as well as in *Chase v. Curtis*, 113 U. S. 452, the only point adjudged was that such statutes were so far penal that they must be construed strictly, and in both cases jurisdiction was assumed by the Circuit Court of the United States, and not doubted by this court, which could hardly have been if the statute had been deemed penal within the maxim of international law. In *Flash v. Conn.*, 109 U. S. 371, the liability sought to be enforced under the statute of New York was the liability of a stockholder arising upon contract, and no question was presented as to the nature of the liability of officers.

But in *Hornor v. Henning*, 93 U. S. 228, this court declined to consider a similar liability of officers of a corporation in the District of Columbia as a penalty. See also *Neal v. Moultrie*, 12 Georgia, 104; *Cady v. Sandford*, 53 Vermont, 632, 639, 640; *Nickerson v. Wheeler*, 118 Mass. 295, 298; *Post v. Toledo, etc., Railroad*, 144 Mass. 341, 345; *Wolverton v. Taylor*, 132 Illinois, 197; *Morawetz on Corporations* (2d ed.), § 908.

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In this view that the question is not one of local, but of international law, we fully concur. The test is not by what name the statute is called by the legislature or the courts of the States in which it is passed, but whether it appears to the tribunal which is called upon to enforce it to be, in its essential character and effect a punishment of an offence against the public, or a grant of a civil right to a private person.

In this country the question of international law must be determined in the first instance by the court, state or national, in which the suit is brought. If the suit is brought in a Circuit Court of the United States it is one of those questions of general jurisprudence which that court must decide for itself, uncontrolled by local decisions. *Burgress v. Seligman*, 107 U. S. 20, 33. *Texas & Pacific Railway v. Cox*, 145 U. S. 593, 605, above cited. If a suit on the original liability under the statute of one State is brought in a court of another State, the Constitution and laws of the United States have not authorized its decision upon such a question to be reviewed by this court. *New York Ins. Co. v. Hendren*, 92 U. S. 286; *Roth v. Ehlman*, 107 U. S. 319. But if the original liability has passed into judgment in one State, the courts of another State, when asked to enforce it, are bound by the Constitution and laws of the United States to give full faith and credit to that judgment, and if they do not, their decision, as said at the outset of this opinion, may be reviewed and reversed by this court on writ of error.

The essential nature and real foundation of a cause of action, indeed, are not changed by recovering judgment upon it. This was directly adjudged in *Wisconsin v. Pelican Ins. Co.*, above cited. The difference is only in the appellate jurisdiction of this court in the one case or in the other.

If a suit to enforce a judgment rendered in one State, and which has not changed the essential nature of the liability, is brought in the courts of another State, this court, in order to determine, on writ of error, whether the highest court of the latter State has given full faith and credit to the judgment, must determine for itself whether the original cause of action is penal in the international sense. The case, in this regard, is analogous to one arising under the clause of the Constitution which forbids a State to pass any law impairing the obligation of contracts, in which, if the highest court of a State decides nothing but the original construction and obligation of a contract, this court has no jurisdiction to review its decision, but if the state court gives effect to a subsequent law, which is impugned as impairing the obligation of a contract, this court has power, in order to determine whether any contract has been impaired, to decide for itself what the true construction of the contract is. *New Orleans Waterworks v. Louisiana Sugar Co.*, 125 U.S. 18, 38. So if the state court, in an action to enforce the original liability under the law of another State, passes upon the nature of that liability and nothing else, this court cannot review its decision; but if the state court declines to give full faith and credit to a judgment of another State, because of its opinion as to the nature of the cause of action on which the judgment was recovered, this court, in determining whether full faith and credit have been given to that judgment, must decide for itself the nature of the original liability.

Whether the Court of Appeals of Maryland gave full faith and credit to the judgment recovered by this plaintiff in New York depends upon the true construction of the provision of the Constitution and of the act of Congress upon that subject.

The provision of the Constitution is as follows: "Full faith and credit shall be given in each State to the public acts, records and judicial proceedings of every other State. And the Congress may, by general laws, prescribe the manner in which such acts, records and proceedings shall be proved and the effect thereof." Art. 4, sec. 1.

This clause of the Constitution, like the less perfect provision on the subject in the articles of Confederation, as observed by Mr. Justice Story, "was intended to give the same conclusive effect to judgments of all the States, so as to promote uniformity, as well as certainty, in the rule among them," and had three distinct objects: First, to declare, and by its own force establish, that full

faith and credit should be given to the judgments of every other State; second, to authorize Congress to prescribe the manner of authenticating them; and third, to authorize Congress to prescribe their effect when so authenticated. Story on the Constitution, §§ 1307, 1308.

Congress, in the exercise of the power so conferred, besides prescribing the manner in which the records and judicial proceedings of any State may be authenticated, has defined the effect thereof by enacting that "the said records and judicial proceedings so authenticated shall have such faith and credit given to them in every court within the United States as they have by law or usage in the courts of the State from which they are taken." Rev. Stat. § 905, re-enacting Act of May 26, 1790, c. 11, 1 Stat. 122.

These provisions of the Constitution and laws of the United States are necessarily to be read in the light of some established principles, which they were not intended to overthrow. They give no effect to judgments of a court which had no jurisdiction of the subject matter or of the parties. *D'Arcy v. Ketchum*, 11 How. 165; *Thompson v. Whitman*, 18 Wall. 457. And they confer no new jurisdiction on the courts of any State, and therefore do not authorize them to take jurisdiction of a suit or prosecution of such a penal nature; that it cannot on settled rules of public and international law be entertained by the judiciary of any other State than that in which the penalty was incurred. *Wisconsin v. Pelican Ins. Co.*, above cited.

Nor do these provisions put the judgments of other States upon the footing of domestic judgments, to be enforced by execution, but they leave the manner in which they may be enforced to the law of the State in which they are sued on, pleaded or offered in evidence. *McElmoyle v. Cohen*, 13 Pet. 312, 325. But when duly pleaded and proved in a court of that State they have the effect of being not merely *prima facie* evidence, but conclusive proof, of the rights thereby adjudicated; and a refusal to give them the force and effect in this respect which they had in the State in which they were rendered denies to the party a right secured to him by the Constitution and laws of the United States. *Christmas v. Russell*, 5 Wall. 290; *Green v. Van Buskirk*, 5 Wall. 307, and 7 Wall. 139; *Insurance Co. v. Harris*, 97 U. S. 331, 336; *Crescent City Co. v. Butchees' Union*, 120 U. S. 141, 146, 147; *Carpenter v. Strange*, 141 U. S. 87.

The judgment rendered by a court of the State of New York, now in question is not impugned for any want of jurisdiction in that court. The statute under which that judgment was recovered was not, for the reasons already stated at length, a penal law in the international sense. The faith and credit, force and effect, which that judgment had by law and usage in New York,

was to be conclusive evidence of a direct civil liability from the individual defendant to the individual plaintiff for a certain sum of money and a debt of record, on which an action would lie, as on any other civil judgment *inter partes*. The Court of Appeals of Maryland, therefore, in deciding this case against the plaintiff upon the ground that the judgment was not one which it was bound in any manner to enforce, denied to the judgment the full faith, credit and effect to which it was entitled under the Constitution and laws of the United States.

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COMMONWEALTH V. NORTHERN ELECTRIC LIGHT AND  
POWER COMPANY.\*

SUPREME COURT OF PENNSYLVANIA, 1891.

(145 Pa. St. 105.)

*What is a "Manufacturing" Corporation?*

Williams, J.: This case presents a new and interesting question, viz.: Is a company that produces electricity, and sells it to customers for the generation of light, heat or power, a manufacturing company, within the meaning of the act of 1885, exempting the capital stock of manufacturing companies from taxation? This case was tried without a jury, and the facts upon which the judgment was based appear in the findings of the court below. One of these, which was based upon the opinion, and largely expressed in the words of an expert electrician, who was called as a witness, asserts that the electricity sold by the company was created by the process adopted by the company. The learned judge says: "The electricity which furnishes the light does not exist until the armature revolves. The revolution of the armature brings into being something that did not exist before,—that is, this electric energy, or energy in this electric form." In the same finding he describes the process by which this product is evolved or created as follows: "Coal is burned under the boilers producing heat. The heat generates steam in the boilers, which moves the engine. The engine supplies the power by which the armature is made to revolve. The revolution of the armature pro-

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\*Com'w. v. Brush Electric Light Co., 145 Pa. St. 147 (1891). Emerson v. Com'w. 108 Pa. St. 111. People v. Wemple, 129 N. Y. 543. Beggo v. Edison Light and Ill. Co. (Ala. 1892).—So. Rep.—and note to Eagle v. Sohn, 41 Ohio St. 691, 83 Am. Rep. 103.

duces electric currents where they did not exist before. The electricity thus generated is carried over wires provided by the company, and delivered to its customers, where it is used to produce light. The process by which electricity is made to furnish light is found to consist of the movement of an electric current from one carbon point to another, which are made part of its circuit. In leaping from one point to another great heat is developed by the energy of the current. This heat liberates or evolves from the carbons a gas, which it burns. The light is thus found to be due partly to the passage of the electric current between the carbon points, and partly to the combustion of the gas furnished by the heated carbons." Notwithstanding these findings, which showed a creation, or "bringing into being where it did not exist before," of the electricity sold by the company, the learned judge held as matter of law that the process was not one of manufacture, because the product was not a material substance. Conceding that the thing sold was "brought into being," made,—“manufactured,” in the common use of that word,—he denied that such making was in a legal sense a manufacture, because it did not appear affirmatively of what the mysterious product was made, and that it was material, as matter is now defined. This conclusion appears to have been drawn from the derivation and definition of the word “manufacture,” and is forcibly presented in a learned opinion, in which lexicons and books of reference are largely drawn upon. It is very clear that the word originally meant “hand-made.” It is equally clear, in the light of the definitions collated by the learned judge, that its meaning has expanded with the advance of the arts and sciences, until it has come to mean as a verb, the making of anything by human art or skill, (Burrill, Law Dict.,) and as a noun, anything made by art or skill (Rap. & L. Law Dict.). The mere appropriation of an article which is furnished by nature is not a manufacture. Thus the liberation of natural gas or oil from the earth, and its transportation to consumers, is not a manufacture; but the production of illuminating gas is. *Nassau Gas-Light Co. v. Brooklyn*, 89 N. Y. 409; also, *Emerson v. Com.*, 108 Pa. St. 111. The collection, storage, preparation for market, and transportation of ice is not a manufacture, but the production of ice by artificial means is. *People v. Ice Co.*, 99 N. Y. 181, 1 N. E. Rep. 669. A telegraph company produces electricity by artificial means, but it uses it in its own business as a carrier of messages for the public; so does a telephone company. Both receive messages for carriage, and deliver them at the point of destination. They transport for their customers. This company whose character we are considering sells the electricity it makes, or “brings into being,” as a commodity. It provides the lamps or

appliances for the use of its customers, by means of which the light is produced. It sells them the electricity, measures it as it is delivered, and is paid according to the quantity furnished. Whatever electricity may be, it seems to be absolutely within the power and under the control of the company that brings it into being. It is compelled by the process employed to come into being. It is secured, stored, poured out, or liberated at will. Its manifestations are both seen and felt. It moves with incredible velocity and power. It carries the tones and inflections of the human voice, or moves loaded cars, depending on the volume of the current and the manner of its application. It may be, in the hands of the physician, a soothing remedial agent, and, in the hands of the law, an instrument of execution swifter and surer than the headsman's axe. It may be too early to say just what it is. The scientists whose views the learned judge adopted may be right or wrong. We have no need to decide that question. Laws are written ordinarily in the language of the people, and not in that of science; and, if this case depended on the question on which it turned in the court below, we should be led by the findings of fact to a different conclusion of law from that which was there reached, and hold that this company was a manufacturing company.

But we think the controlling question in this case is that of the sense in which the words "manufacturing companies" are used in the statute under consideration. It provides that the taxes laid on corporations by the revenue laws of the commonwealth are repealed or abolished as to manufacturing corporations. Now, if there were a class of corporations existing at that date known by the name of "manufacturing companies or corporations," we must assume that the legislature intended that class when it used the name by which the class had been known in previous legislation; and we need go no further than the statute-book to determine the legislative intent in the act of 1885. The act of 1879 imposed a capital-stock tax on all corporations alike, so that we get no help from it. Looking back to the laws under which corporations have been created, we find that in 1836 an act was passed providing for the organization of corporations for the manufacture of iron from the ores with coke or mineral coal, which was subsequently extended so as to include companies using charcoal. This was followed in 1849 by a law which provided for the organization of "manufacturing companies" as a class of corporations. It included the manufacture of woolen, cotton, flax, or silk goods, of iron, paper, lumber or salt. In 1850 it was extended so as to include the manufacture of glass. In 1851 printing and publishing were taken into the class. In 1852 the making of mineral paints and artificial slate

was included. In 1853, quarrying and mining. In 1859 the manufacture of leather and leather goods. Mineral and carbon oils were included by a series of acts passed in 1856, 1859, and 1860. It will thus be seen that the words "manufacturing corporations" had been employed as the name of a definite class of corporations for many years, and that the kinds of manufacture embraced within the class were not left to be settled by conjecture, or by reasoning built upon definitions, but had been settled by actual enumeration in the statutes referred to and some others. When the constitution of 1873 was adopted, and when the general corporation act of 1874 was passed in obedience to its requirements, manufacturing corporations as a class were provided for, and the kinds of manufacture included made certain by a long series of statutes. The act of 1874 provided a uniform mode for the incorporation of companies formed for profit, describing them as corporations of the second class, while corporations not for profit composed the first class. In the second class were included, among others, companies formed for "carrying on any mechanical, mining, quarrying, or manufacturing business, including all the purposes covered by the provisions of the act of general assembly entitled "An act to encourage manufacturing operations in this commonwealth, approved April 7, 1849," and its several supplements. Thereafter any company formed for the prosecution of the objects enumerated in the act of 1849, and its supplements entered the class of manufacturing corporations through the gate opened by the act of 1874, instead of through previous legislation. But, whether they came in the one way or the other, if they were within the class as the legislature had made it, the act of 1885 relieved them from the tax imposed by the act of 1879. A company supplying illuminating gas is, in the general sense of the word, a manufacturing company, (*Nassau Gas-Light Co. v. Brooklyn*, *supra*,) but it is not a member of the statutory class built up under the act of 1849, nor is any corporation engaged in the service of its customers in a *quasi* public capacity. A municipality may furnish water and light to its citizens. A company performing this service may be said to perform a *quasi* public or municipal function, which the municipality may disturb at its pleasure, or supersede altogether. Such companies have never been included in any of the legislation provided for the encouragement and protection of manufacturing corporations, and have no right to share in the benefits of such legislation. They really form a class by themselves. When the act of 1885 was passed laws had been made in adjoining states which gave encouragement to the establishment of factories by exempting them from certain forms of taxation. The mischief to be remedied was the danger that such legislation might lead



to the removal of capital and labor from this state to others, to the detriment of the business and prosperity of our own. The remedy provided was the removal of the tax imposed by the act of 1879, so as to remove the inducement to leave the state. It was as broad as the mischief which it was intended to meet, and made applicable to the class which since 1836 it had been the policy of the state to encourage viz., "manufacturing corporations." It did not reach financial corporations like banks and insurance companies, nor transportation companies, nor companies performing functions partaking of a municipal character, but that class of productive industries which the legislature had sought to encourage as a means of bringing and keeping within our borders capital and labor, to be employed in the development of our mineral wealth, and in the production of the staples of commerce. We think the learned judge reached a correct conclusion in this case. The appellant is not within the exemption or immunity provided by the act of 1885, but we prefer to rest our judgment on the definition of "manufacturing corporations" which the legislature has adopted and adhered to for more than half a century, rather than upon the meaning of the word "manufacture" as it is given by lexicographers. The judgment is affirmed.

## CHAPTER XIII.

## TRANSFER OF MEMBERSHIP.

## LUND V. WHEATON ROLLER MILL CO.

SUPREME COURT OF MINNESOTA, 1893.

(50 Minn. 36.)

*Sale of Stock.—Necessity for Transfer on the Books of the Corporation.—Attachment.*

Dickinson J.: The defendant, the Wheaton Roller Mill Company, is a corporation created under the Gen. St. of 1878. c. 34, title 2. In June, 1890, one Howell owned and held 40 shares of the stock of the corporation, certificates for which had been issued to him. At that time he in good faith and for a valuable consideration sold and assigned such stock to the intervener, the Grant County Bank, but no entry of such transfer was made in the books of the mill company.

In November in the same year, in an action prosecuted by the plaintiffs against Howell,—who appeared on the books of the corporation as being still the owner of the stock,—the stock was levied upon by virtue of a writ of attachment. The plaintiffs then had no knowledge that the stock had been transferred by Howell. Afterwards the plaintiffs recovered judgment in the action against Howell, and under execution issued thereon, in December, 1890, the stock was levied on and sold, the plaintiffs being the purchasers. The plaintiffs had notice of the intervener's claim when the levy was made under the execution. The sole question to which attention will be directed is whether by force of the statute the sale and assignment of the stock to the bank by Howell was ineffectual as to attaching creditors of the assignor, by reason of the fact that no entry of the transfer had been made on the books of the corporation.

The statute referred to is § 8, t. 1, c. 34, Gen. St. 1878, which by force of section 110 of the same chapter (section 46, c. 34, G. St. 1866) is made applicable with respect to corporations organized under title 2. It is in terms as follows; "The transfer of shares is not valid, except as between the parties thereto, until it is regularly entered on the books of the company, so far as to show the names of the persons by and to whom transferred, the

numbers or other designation of the shares, and the date of the transfer. \* \* \* The books of the company shall be so kept as to show intelligibly the original stockholders, their respective interests, the amount which has been paid in on their shares, and all transfers thereof; and such books or a correct copy thereof, so far as the items mentioned in this section are concerned, shall be subject to the inspection of any person desiring the same."

It is also provided by § 114, c. 34, Gen. St. 1878, (§ 49, c. 34, Gen. St. 1866,) that "the stock of any such corporation shall be deemed personal property, and be transferable only on the books of such corporation, in such form as the directors prescribe. \* \* \* "

The law cannot be said to be generally settled and uniform as to whether an unregistered sale and transfer of stock, which either by statute or charter is declared to be transferable only on the books of the corporation, is effectual to pass the property as against subsequent attaching creditors of the vendor. The decisions are contradictory. But we do not feel ourselves at liberty to now treat the question as a new one in this state. As early as May, 1879, in the case of *Baldwin v. Canfield*, 26 Minn. 43, 1 N. W. Rep. 261, it was held that an unregistered transfer of stock in pledge to secure indebtedness of the pledgor was effectual. This decision was cited and followed in *Joslin v. St. Paul Distilling Co.*, 44 Minn. 183, 47 N. W. Rep. 337. The court in *Baldwin v. Canfield*, referring to the above-cited § 49, ch. 39, Gen. St. 1866, said: "Provisions of this kind are intended solely for the protection and benefit of the corporation; they do not incapacitate a shareholder from transferring his stock without any entry upon the corporation books. [citing authorities.] Except as against the corporation, the owner and holder of shares of stock may, as an incident of this right of property, transfer the same as any other personal property of which he is the owner." It is true that the court made no reference to section 8 of that chapter, which by a force of section 46, Gen. St., 1866, became a part of the law concerning corporations created under title 2. An examination of the briefs in that case shows that the latter section was not referred to, and it seems probable that the attention of the court was not directed to it. When the structure of the statute is observed, it will be seen that both counsel and court might naturally fail to discover the applicability to title 2 of this section 8, found in title 1, and relating to a subject specifically treated of in section 49, title 2. However that may be, and even if a consideration of the provisions of section 8 might possibly have led to a different conclusion as to the validity of the pledge, that decision, made nearly 13 years ago, and hitherto unquestioned, should now be deemed decisive of the

question. It has probably been generally so regarded, and it is believed that transfers of stocks in pledge and by sale have been extensively made, without having the transaction entered on the books of the corporations. The rule of *stare decisis* should deter us from now declaring the statute law to be different from what it has heretofore been pronounced to be. We therefore follow former decisions, without entering upon a consideration of the construction which might be given to section 8 of the statute if the question were a new one. In deciding the case in this way, we would not be understood as expressing the opinion that a proper construction of the statute would lead to a different conclusion. The tendency of many decisions is in accordance with the rule heretofore announced in this court, and now followed. See *Robinson v. Bank*, 94 N. Y. 637; *McNeil v. Bank*, 46 N. Y. 325, 331, and cases cited; *Finney's Appeal*, 59 Pa. St. 398; *Turnpike Co. v. Gerhah*, (Pa. Sup.) 13 Atl. Rep. 90; *Bank v. McElrath*, 13 N. J. Eq. 24; *Hunderdon Co. Bank v. Nassau Bank*, 17 N. J. Eq. 497; *Thurber v. Crumb*, 86 Ky. 408, 6 S. W. Rep. 145; *Continental Nat. Bank v. Eliot Nat. Bank*, 7 Fed. Rep. 369; *Cook, Stocks*, § 487.

Judgment affirmed.

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NOTE.—*Kern v. Day* (La. 1868.) 40 Am. & R. C. C. 119; *Boston Music Hall Assn. v. Cary*, 129 Mass. 485 (1890).

## PECK V. PROVIDENCE GAS CO.

SUPREME COURT OF RHODE ISLAND, 1892.

(17 R. I. 275.)

### *Liability of a Corporation for Allowing a Transfer of Stock in Breach of Trust.*

Tillinghast, J.: We are asked by the complainants to reconsider our opinion previously delivered in this case, (see Index H, H, 84, 21 Atl. Rep. 543,) on the ground that it is in conflict with the well-settled rule of law in such cases, in that the rule which we adopted in determining the question of the liability of the respondent corporation, in permitting a registry of the transfer of the stock in question to be made upon its books, fails to secure to the *cestuis que trustent* the amount of protection to which they are legally entitled. The contention is that the respondents,

being charged with the knowledge of the trust, and the transfers of stock being in such form that the transaction might be either a pledge or a sale, that is, that the transaction might be one, permitted by the will of Allen O. Peck, or in fraud of that instrument, it was incumbent on the respondents to make that investigation. In other words, the contention is that the respondents were in the position of trustees for the complainants and, as such, were under obligations to resolve all doubts before permitting the transfers to be made. Briefly stated, the case is this: A. holds stock in trust for B., with power to sell the same, in his discretion for other security. C. is the custodian of the stock, with knowledge of A.'s trust, and also of his power to sell. C. permits A., by his lawfully constituted attorney, D., to transfer a part of the stock on the books of the corporation to E., a national bank, and another part to F., "cashier." The transfers were in fact by way of pledge, to secure the individual indebtedness of the said attorney, D., and were made without authority, and in fraud of the rights of B. C. had no knowledge of the wrongful act of A.'s attorney, except in so far as such knowledge is to be imputed to him from the fact that he knew that A. held the stock in the manner aforesaid. Under these circumstances, was C. guilty of negligence in permitting the transfers to be made? It is doubtless a well settled rule of law that a corporation occupies, in many respects, at least, the position of a trustee towards its stockholders; that it is bound to exercise reasonable diligence in protecting the title of a beneficial owner of stock; and that it is responsible for any injury sustained by such beneficial owner through its negligence or misconduct. *Caulkins v. Gas-Light Co.*, 85 Tenn. 683, 4 S. W. Rep. 287; *Perry, Trusts*, § 242; *Loring v. Salisbury Mills*, 125 Mass. 138, 150; *Shaw v. Spencer*, 100 Mass. 382; *Duncan v. Jaudon*, 15 Wall. 165; *Mor. Priv. Corp.* § 181. See, also, the rule as laid down by this court in *Peck v. Bank*, 16 R. I. 710, 713, 19 Atl. Rep. 369.

The real difficulty in cases of this sort, however, is not in laying down the general rule to be applied, this being so well established as hardly to admit of discussion, but in applying that rule to the facts of the particular case in hand. In this case the important question which arises is as to how far it was the duty of the transfer agent to inquire into the authority of the trustee to make the transfer. The gas company had notice in law of the provisions of the will of Allen O. Peck. It knew, therefore, that the executrix had power to sell the stock in question. Henry C. Whitaker, her lawfully constituted agent, who was also her brother, requested that the said stock should be transferred on the books of the corporation to other parties, which

request was granted. Having the right to sell the stock, and not having the right to make any other disposition thereof, was not the transfer agent of the gas company warranted in assuming that the transaction was a sale and not a pledge? Or, to state the question differently, was there anything in such a transaction that would lead an ordinarily prudent man to suspect that any wrong was being committed? We think not. It is to be presumed that men are honest in their business transactions until the contrary appears, or, at any rate, until or unless something appears which would put an ordinary prudent man upon his inquiry in relation thereto. Almost all commercial transactions are necessarily based upon this theory. And when one proposes to do an act which is apparently rightful, although it may possibly be wrongful, the one with whom he is dealing has the right to presume that it is rightful. *Omnia rite esse acta*. Brown, Leg. Max. 731; Hatch v. Bayley, 12 Cush. 27; Carter v. Bank, 71 Me. 448, 454.

Applying this principle to the case at bar, we think that the respondent corporation had the right to presume that the transfers of the stock in question were made in pursuance of the authority contained in the aforesaid will, and not in fraud thereof. The respondents, however, seem to contend for the reverse of this doctrine; for they say: "It is not enough that the transaction may be legitimate. To adopt such a rule would be to permit corporations to be parties to any kind of an operation, provided only they could imagine circumstances under which that operation might be permissible." In Wharton on Evidence (section 1249) this doctrine is stated as follows: "When an instrument is susceptible of two conflicting probable constructions, the court will adopt that construction which is most consistent with good faith, and will hold that such construction was intended by the parties. And this rule of construction applies to cases where an act or fact is fairly susceptible of two interpretations, one lawful and the other unlawful." That is to say if we rightly understand the contention, it is that, under the circumstances attending the transfers of stock in this case, it was apparently probable that the acts were wrongful and fraudulent, and only barely possible that they might have been honest and rightful. Such a position is not well founded either in principle or authority. It is contrary to the well-established maxims of law and the ethics of commercial transactions.

But assuming that we have stated the position of the complainants too strongly, and that they intend only to take the more conservative ground that the transfers of stock, which the gas company permitted to be made, might as well have been wrongful

as rightful under the circumstances surrounding the transfer, yet we do not think that this position is tenable. We cannot agree to the proposition that on the face of the transaction, there was as much to show that it was wrongful as there was to show that it was rightful. The power of the trustee to sell the stock, coupled with the presumption that she was acting honestly, and in pursuance of that power, made the transfer apparently rightful, or, at any rate, the act, under the circumstances, was not such as ought to cause a reasonably prudent man to suspect that it was wrongful. Ordinary diligence, and not suspicious watchfulness, is the measure of duty which a corporation owes to its stockholders in such cases. In this case we do not see that either suggestion of danger or ground for suspicion exists.

But the complainants further contend that the fact that the transfers of the stock were all either to national banks, or the cashiers of such banks in their official capacity, clearly indicated that a pledge, and not a sale, was contemplated by the transferer, as such banks have no power to purchase shares in other corporations. The same position was strenuously urged at the former hearing, and is fully considered by the court in its opinion. We see no occasion to modify the views therein expressed. An examination of the cases relied on by the complainants, in support of their petition for a reargument, fails to satisfy us that they are in conflict with the decision previously rendered in this case. We will briefly consider them. *Lord v. Salisbury Mills*, 125 Mass. 138, was a case where the defendant corporation had notice that the shares of stock in question were held by George H. Rogers, trustee for Mrs. E. B. Mountford. By the indenture of trust the trustee was authorized to sell and reinvest the trust property only upon first obtaining the written consent of the *cestui que trust*, if at the time within the United States, and the evidence showed that she was within the United States at the times of the sales and transfers complained of. It was held that the transfers having been made without due inquiry into the authority of Rogers, the trustee, to make them, and being invalid against the *cestui que trust*, the defendant was liable. An examination of the powers of the trustee in that case would have revealed the fact that he had no authority to transfer the stock without the written assent of his *cestui que trust*. Failing to make this inquiry, the defendant was clearly guilty of negligence. *Bohlen's Estate*, 75 Pa. St. 304, was a case where the executors of a will, who were also trustees thereunder, had power, in their discretion, to sell the real estate, but had no power, in terms, to transfer stocks. They did not sell the stock which the testator owned at his decease, it not being needed for the purposes of administration, but retained it unconverted, and

it passed into and formed a part of the trust-estate. The defendant had express notice that the stock was held by trustees, as the trust appeared on the certificates and on the transfer books of the corporation. After the death of the trustees named in the will, the orphans' court appointed others in their place, and the stock was duly transferred to them in their said capacity. The defendant afterwards permitted one of said trustees, who acted for himself, and also for the other under a power of attorney which gave full discretionary power in the premises, to transfer said stock. He converted the proceeds to his own use, and absconded. It was held that the successors of the trustees named in the will possessed only such powers as they derived from the will or were incidental to the office of trustee in the management of the trust-estate; and also that a delegation of discretionary power from one trustee to his co-trustee could not legally be made, and consequently that the sales of the stocks were invalid, and the defendant liable. *Bank v. Seton*, 1 Pet. 299, was a case to compel the appellants to permit a transfer of \$3,000 of the capital stock of the bank standing in the name of Adam Lynn, and held by him as trustee of the appellees. The bank refused to make the transfer, on the ground that Lynn was indebted to it for loans made to him, and that, under the charter of the bank, it had the right to hold said stock for the payment of his debt. The proof showed that the board of directors had full knowledge that the stock was not the property of said Lynn, but was held by him in trust for the complainants when they permitted it to be transferred. Held, that the bank was liable. The court said (page 309): "It is a well-settled rule in equity that all persons coming into possession of trust property, with notice of the trust, shall be considered as trustees, and bound with respect to that special property to the execution of the trust." *Hutcheson v. Jones*, 2 Madd. 125; *Adair v. Shaw*, 1 Schoales & L. 262. In *Sweeny v. Bank*, 12 Can. Sup. Ct. Rep. 661, stock standing in the name of "A. B. in trust," without any power of sale, or any evidence for whom or upon what trust, was, by A. B., transferred as collateral security for his own individual debt to the Bank of Montreal, which had notice how the stock stood on the record. It was held that the transfer was *prima facie* suspicious and a breach of trust, and such as should have put the bank upon its inquiry. This decision is in accord with the current of American authorities upon the question there considered. *Caulkins v. Gas-Light Co.*, 85 Tenn. 634, 4 S. W. Rep. 287, was a case where the will creating the trust gave the trustee no power of sale. The defendant, with full knowledge of the contents of the will, whereby it appeared that the trustee was only entitled to the



income of the stock during his life, nevertheless permitted him to sell and transfer the same absolutely to a purchaser, in good faith, for value and without notice. It was held that the company was liable to the *cestui que trust*. A careful examination of the facts in that case show that it was one of inexcusable negligence on the part of the defendant. *Bayard v. Bank*, 52 Pa. St. 232, was a case where the defendants, as agents of the commonwealth, issued to Henry D. Gilpin, trustee, certificates of certain stock, and also to Henry D. Gilpin, trustee of Mary Gilpin, certificates of certain stock. Gilpin having deceased, and Thomas F. Bayard having been appointed trustee of Mary Gilpin, the executors of Mr. Gilpin transferred all of said stock to him as "trustee of Mary Gilpin," and certificates therefor were issued by the defendants to "Thomas F. Bayard, trustee of Mary Gilpin." Mary Gilpin afterwards died, leaving a will. After her death, Mr. Bayard, as trustee, sold \$4,000 of the stock, and authorized its transfer to his vendee. The defendants, on demand, refused to permit the transfer until the terms of the trust were submitted to their attorney, and he should be satisfied that the sale was made in due execution of the trust. It was held that the plaintiff had no right to insist upon being allowed to make a transfer of stock which he held ostensibly in trust for Mary Gilpin, without exhibiting to the defendants an authority to transfer beyond the certificate. The court laid down the following rule, (page 235): "That a bank or other corporation, and also these defendants, are trustees to a certain extent for stockholders, that is, for the protection of individual interests, cannot be denied. They are alike trustees of the property and of the title of each owner. They have in their keeping the primary evidence of title, and they are justly held to proper diligence and care in its preservation. From this it results that they may rightfully demand evidence of authority to make a transfer before they permit it to be made. Their own safety requires that they be satisfied of the right of the person proposing to make a transfer to do what he proposes." *Railway Co. v. Humphries*, (Miss.) 7 South. Rep. 522, was a case where an executor transferred stock belonging to the estate, after he had been removed by the court from his office as executor. It was held that he had no power to sell the stock after his removal, and hence that the defendant railroad company was liable for its wrongful transfer. *Marbury v. Ehlen*, 72 Md. 206, 19 Atl. Rep. 648, was a case where stock, standing in the name of a trustee, was permitted to be transferred with constructive knowledge on the part of the defendant corporation of the will under which the stock was held in trust, and also with knowledge that the trustee could not transfer the same without

an order of court. It was held that the defendants, having permitted the transfer to be made without an order of court, were liable.

In *Bank v. Cady*, 15 App. Cas. 267, the stock in question stood in the name of one Williams. After his death his executors signed a transfer in blank, on the back of the certificates, for the purpose of having the stock transferred into their names as executors, and handed them to their London brokers to send to the company in New York. Blakeway, one of the brokers, fraudulently used the certificates as collateral security for loans made to his firm. The evidence offered in the case showed that the certificates were not "in order," and would not, according to the rules of the New York Stock Exchange, pass from hand to hand. The evidence also showed that the certificates, as indorsed, would not be accepted in delivery on the London Stock Exchange. It was held that the act of the executors did not necessarily imply an intent on their part to transfer the stock to anybody else, but was entirely consistent with their actual intention to transfer it into their own names. Lord HALSBURY, L. C., in the course of his opinion, said, (15 App. Cas. 273): "Now, the form of the certificates, and of that which is intended to be used as a transfer, when a registered owner makes the transfer, appears to me to be all-important. I have intentionally, in what I have said before, refused to adopt the phrase used at the bar, 'that the executors executed the transfer.' The document, such as it is, with the names of the two executors subscribed, will not read so as to be a perfect and intelligible document. The person who begins by describing himself as the owner of the shares is not the person who signs; and, as LINDLEY, L. J., very pertinently inquires: 'What is it that the executors have done? What representation have they made, which they are precluded from denying or explaining away?' The mere form of the document which they have signed certainly does not, in itself, purport to show that they are intending to give a complete title to anybody. But undoubtedly a document may by usage become so well understood, in a particular sense, that a person may be well estopped from denying that, when he issues it to the world, it must bear the sense which usage has attached to it. And that brings one to inquire whether it is true that the issue of this document to the world in this form would show that the person signing had intended to give a complete title to any one into whose hands it should come. To my mind, the evidence shows, beyond doubt, that the document might mean at least one of two things,—either that the executors were going to sell these shares and transfer them to someone else, or that they were signing in order that they might be themselves

registered in the books of the company as the legal representatives of the deceased holder, John Michael Williams. Now, if that is all that the document upon the face of it represents,—and I cannot doubt that, when all the evidence is looked to, that is not an unfavorable mode of representing it towards the appellants,—let us see what would have been the result if Blakeway, instead of simply tendering the document as security for a loan to himself, had said in plain terms to the bank what I have described as being the representation made by the document itself: 'I tell you [the bank] I have been intrusted with these certificates for only one of two purposes, but I will not explain which,—either to sell, or get the names of the owners of them registered in the books of the company.' Can there be any difference between that which is stated in plain terms and that which, as a matter of business, ought to have been inferred from the nature of the document itself? I think none."

We have quoted thus at length from this case because of its high authority, and also because it was much relied on in argument by the counsel for the complainants in support of his position. We are unable, however, to agree with him in his deductions therefrom. The form of the certificates themselves, in that case, was evidently sufficient to have put the defendant bank upon its inquiry as to the authority of the holder to negotiate them. It appeared thereon that they were "transferable in person or by attorney on the books of the company, only on the surrender and cancellation of this certificate by an indorsement thereof hereon, and in the form and manner which may at the time be required by the transfer regulations of the company." Mere delivery of these certificates, with the indorsement of the executors thereon, did not invest the holder with the ownership thereof, in the sense that no further act was required to perfect his right, the transferrers not being named in the certificate, and not being the registered owners of the shares; and, as stated by LORD WATSON in giving his opinion in the case, (15 App. Cas. 279): "Whatever may be the effect of an instrument so executed, one thing is clear: that it cannot be regarded as, either in law or by custom, equivalent to a certificate and transfer executed by the registered owner himself. \* \* \* Although registration may be obtained upon the production of such evidence, the documents are not 'in order,' or in other words, are not accepted in commercial circles as sufficient vouchers of title, unless they are accompanied by an extract of the probate, and an attestation of the genuineness of the executor's signatures, by the United States consul or other competent officers." Out of five officials of London banks who were examined for the appel-

lants, not one was able to give an instance of a transfer signed by executors having been taken as security, except in that case. We do not see how the case can be considered an authority in support of the complainants' position. *Lowry v. Bank, Taney, 310*, is a leading case on the subject under consideration. In that case the stock in question had been specifically bequeathed upon certain express trusts, and there was no power to sell it, except for the purpose of paying the debts of the testator. Eight years after the death of the testator, Samuel Jones, one of the executors transferred the stock for his own personal use of which fact the court found, from the circumstances of the case, the bank had notice, and it was therefore held liable. *Magnus v. Bank, 36 Ch. Div. 25*, was a case where certain trustees transferred stock to the defendant bank as security for a loan. The loan having been paid, the bank, instead of retransferring it to the mortgagors, the trustees, transferred it to a third party, a nominee of one of the trustees, whereby it became lost to the trust. It was held that a mortgagee whose debt has been paid holds the property in trust to reconvey to the mortgagor. The bank having failed to so reconvey was liable. In that case, therefore, the opportunity of acting dishonestly on the part of one of the trustees, of which he availed himself, was given to him by the breach of duty of the bank. In *Tafft v. Railroad Co., 84 Cal. 131, 24 Pac. Rep. 436*, the decision turns entirely upon the construction of the power of attorney under which the stock was transferred. The court decided that the power of attorney did not authorize the stock to be transferred in the manner and form that it was transferred, and, furthermore, that it was not transferred, in accordance with the by-laws of the defendant corporation, nor of the provisions of the Civil Code of the state. *Chew v. Bank, 14 Md. 299, 318*, was a case where the bank transferred stock under a power of attorney from a person who was insane. It was held: (1) That a power of attorney given by a lunatic is void. (2) That a bank transferring stock under a power of attorney takes the risk of its being valid. If the power of attorney is void for any cause, (e. g., if it be forged, or given by a *feme covert*, infant or lunatic,) the bank is responsible. (3) The fact that it did not know that the power was void cannot help it. It may refuse to recognize the power.

Owing to the importance of the question involved in this case, especially to the complainants, and the commendable diligence and zeal displayed by counsel in the trial thereof, we have thus carefully reviewed our former decision, together with the authorities cited in opposition thereto. But we are unable to arrive at any different conclusion from that therein announced. In our

investigation we have not been unmindful of the fact that the law strives, as far as possible, to protect the interests of the *cestuis que trustent*. *Smith v. Ayer*, 101 U. S. 320, 327; *Colt v. Lasnier*, 9 Cow. 320, 342; *Collenson v. Lister*, 7 De Gex, M. & G. 634, 637. But, while this is so, it never visits the sins of a wrongdoer upon one who is innocent, in order to find a remedy. That a great wrong has been committed against the complainants in this case is clearly manifest. But the sole author of that wrong is now beyond the reach of human tribunals. Petition for reargument denied and dismissed, and former decision affirmed.

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EAST BIRMINGHAM LAND CO. V. DENNIS.

SUPREME COURT OF ALABAMA. 1888.

(85 Ala. 585.)

*Fraudulent Transfer of Shares—Innocent Purchaser.*

Somerville, J.: We concur in the conclusion reached by the judge of the city court, that the appellee, Dennis, complainant in the bill, is the owner of the ten shares of stock which are the subject of litigation in the present suit. The testimony satisfactorily proves that the certificate of stock, indorsed in blank by Dearborn, who was the owner on the books of the defendant corporation, was the property of the appellee, and was taken or stolen from his possession without any negligence on his part whatever, several months before it was purchased by the defendant Mudd, who innocently bought and paid value for it some time in March, 1888.

The only question is whether Mudd, who paid full value for this stock, without notice of the complainant's claim to it, acquired a title superior to that of complainant.

The established rule is that no person can ordinarily be deprived of his ownership of property save by his own consent or his negligence. The only exception to this rule is the case of a *bona fide* purchaser for value of negotiable paper. We have no reference, of course, to the taking of property for public uses by judicial condemnation, which may be done without the owner's consent.

It cannot be contended, with any degree of plausibility, that, under the facts of this case, the complainant was guilty of negligence or the want of ordinary care in the custody of the certifi-

cate. He kept it in a box in the vault of a banking-house, whence it was abstracted by some unknown person, apparently without any fault on his part.

Nor does any question arise involving the rights of a subsequent *bona fide* purchaser of stock from one shown to be the owner on the corporate books, who has already made a prior unregistered transfer of it to another purchaser. All such transfers made by the true owner, and not registered on the books of the corporation within fifteen days, are declared by statute to be "void as to *bona fide* creditors or purchasers without notice." Code 1886, § 1671, *Fisher v. Jones*, 82 Ala. 117, 3 So. Rep. 13. If the defendant Mudd had claimed by a subsequent purchase from Dearborn, the owner of the stock on the corporate books, this question would arise. But he does not so claim, his title being derived through the complainant Dennis, himself, by two or more intermediate transferees, the first of whom was a fraudulent holder without title. Whether Mudd's title to the stock, therefore, is superior to that of Dennis, depends on whether a certificate of stock, indorsed in blank by the owner, is to be treated as a negotiable paper. The rule is well settled that a *bona fide* purchaser of negotiable bill, bond, or note, although he buys from a thief, acquires a good title, if he pays value for it, without notice of the infirmity of his vendor's title. The authorities are clear in support of the view that a certificate of corporate shares of stock, in the ordinary form, is not negotiable paper; and that a purchaser of such certificate, although indorsed in blank by the owner, where no question arises under the registration laws, obtains no better title to the stock than his vendor had, in the absence of all negligence on the part of the owner, or his authority to make the sale. This question arose and was decided by the New York Court of Appeals in *Mechanic's Bank v. Railroad Co.*, 13 N. Y. 599, (1856). It was there held that such a certificate does not partake of the character of a negotiable instrument, and that a *bona fide* assignee, with full power to transfer the stock, takes the certificate subject to the equities which existed against his assignor. Such certificates, said COMSTOCK, J., "contain no words of negotiability. They declare simply that the person named is entitled to certain shares of stock. They do not, like negotiable instruments, run to the bearer or order of the party to whom they are given." They were said to be in some respects like a bill of lading or warehouse receipt, being "the representative of property existing under certain conditions, and the documentary evidence of title thereto." The most that can be said is that all such instruments possess a sort of *quasi* negotiability, dependent on the custom of merchants and the convenience of trade. They are

not, in the matter of transferability, protected strictly as negotiable paper.

In *Shaw v. Spencer*, 100 Mass. 382, it was also decided that a certificate of corporate stock, transferred in blank on its back, was clearly not a negotiable instrument. "No commercial usage," it was said, "could give to such an instrument the attribute of negotiability. However many intermediate hands it may pass through, whoever would obtain a new certificate in his own name must fill out the blanks \* \* \* so as to derive title to himself directly from the last recorded stockholder, who is the only recognized and legal owner of the shares." The case of *Sewall v. Water-Power Co.*, 4 Allen, 282, decided by the same court a few years before, is referred to as a precedent in support of this conclusion.

The precise point in the present case was also decided in *Barstow v. Mining Co.*, 64 Cal. 388, S. C. 1 Pac. Rep. 349, where it was expressly held that a *bona fide* purchaser of stock standing on the company's books in the name of the former owner, regularly indorsed by him, and stolen from the present owner without his fault, gets no title. The decision was based on the fact that such certificates are not negotiable instruments, but simply muniments of title, and evidences of the holder's right to a given share in the property and franchises of the corporation. It was observed, in regard to the matter of negligence, as follows: "But if the purchaser from one who has not the title, and has no authority to sell, relies for his protection on the negligence of the true owner, he must show that such negligence was the proximate cause of the deceit."

The same principle was applied to bills of lading in *Gurney v. Behrend*, 3 El. & Bl. 622, decided by the English Queen's Bench, where an instrument of that kind, indorsed in blank by the consignor, and sent by him to his correspondent, had been misappropriated. The correspondent, without authority, fraudulently transferred the bill for value, and it was held by Lord CAMPBELL that, for the want of the element of negotiability in the paper, the title to the goods was unaffected by the transaction.

The doctrine of *Barstow v. Mining Co.*, *supra*, is well supported by authority, and, in our judgment, announces a correct principle of law, and we fully approve it. *Willey v. Sargent*, 14 Amer. Dec., note, p. 427, and cases there cited; *Cook, Stocks*, §§ 7, 10, 192, 368, 437; 2 Daniel, Neg. Inst. (3d Ed.) § 1708g. It harmonizes entirely with the declaration of our statute that shares of stock in private corporations are "personal property, transferrable on the books of the corporation" in accordance with the rules and regulations of the corporation. Code 1886, § 1669; *Campbell v. Woodstock Iron Co.*, 83 Ala. 451, 3 So. Rep. 369.

There is a class of cases, not to be confounded with the one in hand, where the holder of such a certificate of stock, indorsed in blank, is clothed with power as agent or trustee to deal with such stock to a limited extent, and transfers it by exceeding his powers, or in breach of his trust. In such cases it has often been held that the true owner, having conferred on the holder by contract all the external *indicia* of title, and an apparently unlimited power of disposition over the stock, "is estopped to assert his title as against a third person, who, acting in good faith, acquires it for value from the apparent owner." 2 Daniel, Neg. Inst. (3d ed.), § 1708g; *McNeil v. Bank*, 46 N. Y. 325; *Turnpike Co. v. Ferree*, 17 N. J. Eq. 117; *Prall v. Tilt*, 28 N. J. Eq. 479; *Bank v. Livingston*, 74 N. Y. 223. These cases rest on the principle that it is more just and reasonable, where one of two innocent parties must suffer loss, that he should be the loser who has put trust and confidence in the deceiver than a stranger who has been negligent in trusting no one. *Allen v. Maury*, 66 Ala. 10.

It being an established principle of law that certificates of stock are not to be regarded as negotiable paper, it is not permissible to prove a custom or usage among stock-brokers to the contrary. No usage is good which conflicts with an established principle of law, any more than one which contravenes or nullifies the express stipulations of a contract. *Dickinson v. Gay*, 83 Am. Dec. 656, note 664; *Railroad Co. v. Johnson*, 75 Ala. 576; *Lehman v. Marshall*, 47 Ala. 362.

The decree of the court below is in accordance with these views, and must be affirmed.

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## MCNEIL V. TENTH NATIONAL BANK.

NEW YORK COURT OF APPEALS, 1871.

(46 N. Y. 325.)

Rapallo, J.: The pledge of the plaintiff's shares by his brokers, for a larger sum than the amount of their lien thereon, was a clear violation of their duty, and excess of their actual power. And if the effect of the transaction was merely to transfer to the appellant, through Fred. Butterfield, Jacobs & Co., the title or interest of Goodyear Brothers and Durant in the shares, the judgment appealed from was right.

It must be conceded, that as a general rule, applicable to property other than negotiable securities, the vendor or pledgor



can convey no greater right or title than he has. But this is a truism predicable of a simple transfer from one party to another where no other element intervenes. It does not interfere with the well-established principle, that where the true owner holds out another, or allows him to appear, as the owner of, or as having full power of disposition over the property, and innocent third parties are thus led into dealing with such apparent owner, they will be protected. Their rights in such cases do not depend upon the actual title or authority of the party with whom they deal directly, but are derived from the act of the real owner, which precludes him from disputing, as against them, the existence of the title or power which through negligence or mistaken confidence he caused or allowed to appear to be vested in the party making the conveyance. *Pickering v. Busk*, 15 East, 38; *Gregg v. Wells*, 10 Adol. & El., 90; *Saltus v. Everett*, 20 Wend., 268, 284; *Mowrey v. Walsh*, 8 Cow., 238; *Root v. French*, 13 Wend., 570.

The true point of inquiry in this case is, whether the plaintiff did confer upon his brokers such an apparent title to, or power of disposition over the shares in question, as will thus estop him from asserting his own title, as against parties who took *bona fide* through the brokers.

Simply intrusting the possession of a chattel to another as depositary, pledgee or other bailee, or even under a conditional executory contract of sale, is clearly insufficient to preclude the real owner from reclaiming his property, in case of an unauthorized disposition of it by the person so entrusted. *Ballard v. Burgett*, 40 N. Y. R., 314. "The mere possession of chattels, by whatever means acquired, if there be no other evidence of property or authority to sell from the true owner, will not enable the possessor to give a good title." Per Denio, J., in *Covill v. Hill*, 4 Denio., 323.

But if the owner intrusts to another, not merely the possession of the property, but also written evidence, over his own signature, of title thereto, and of an unconditional power of disposition over it the case is vastly different. There can be no occasion for the delivery of such documents, unless it is intended that they shall be used, either at the pleasure of the depositary, or under contingencies to arise. If the conditions upon which this apparent right of control is to be exercised, are not expressed on the face of the instrument, but remain in confidence between the owner and the depositary, the case cannot be distinguished in principle, from that of an agent who receives secret instructions qualifying or restricting an apparently absolute power.

In the present case, the plaintiff delivered to and left with his brokers, the certificate of the shares, having indorsed thereon the

form of an assignment, expressed to be made "for value received," and an irrevocable power to make all necessary transfers. The name of the transferee and attorney, and the date were left blank. This document was signed by the plaintiff, and its effect must be now considered.

It is said in some English cases, that blank assignments of shares in corporations are irregular and invalid; but that opinion is expressed in cases where the shares could only be transferred by deed under seal, duly attested, and is placed upon the ground that a deed cannot be executed in blank.

Without referring to the American doctrine on that subject, it is sufficient to say that no such formality was requisite in this case. It was only necessary to a valid transfer as between the parties, that the assignment and power should be in writing. The common practice of passing the title to stock by delivery of the certificate with blank assignment and power has been repeatedly shown and sanctioned in cases which have come before our courts. Such was established to be the common practice in the city of New York, in the case of *The New York and New Haven Railroad Company v. Schuyler*, 43 N. Y., 41, and the rights of parties claiming under such instruments were fully recognized in that case. And in the case of *Kortright v. The Commercial Bank of Buffalo*, 20 Wend., 91, and 22 Wend., 348, the same usage was established as existing in New York and other States, and it was expressly held that even in the absence of such usage a blank transfer on the back of the certificate, to which the holder has affixed his name, is a good assignment; and that a party to whom it is delivered is authorized to fill it up, by writing a transfer and power of attorney over the signature.

It has also been settled, by repeated adjudications, that, as between the parties, the delivery of the certificate, with assignment and power indorsed, passes the entire title, legal and equitable, in the shares, notwithstanding that, by the terms of the charter or by-laws of the corporation, the stock is declared to be transferable only on its books; that such provisions are intended solely for the protection of the corporation, and can be waived or asserted at its pleasure, and that no effect is given to them except for the protection of the corporation; that they do not incapacitate the shareholder from parting with his interest, and that his assignment, not on the books, passes the entire legal title to the stock, subject only to such liens or claims as the corporation may have upon it, and excepting the right of voting at elections, etc. *Angell and Ames on Corporations*, 8th ed., § 354; *Bank of Utica v. Smalley*, 2 Cow., 770; *Gilbert v. Manchester Co.*, 11 Wend., 627; *Kortright v. Commercial Bank of Buffalo*, 22 Wend., 362; *N. Y. and N. H. R. R. Co. v. Schuyler*, 34 N. Y., 80.

In the case of *Kortright v. Com. Bank*, Chancellor Walworth, in a dissenting opinion, strenuously maintained, in conformity with his previous decision in *Stebbins v. Phoenix Ins. Co.*, 3 Paige, 356, that by a transfer not on the books, the transferee acquired only an equitable right to or lien on the shares; and that, having but an equitable right or lien, he took subject to all prior equities which existed in favor of any other person from whom such assignment was obtained. 22 Wend., 352, 353, 355. But his view was overruled by the majority of the court. The action was at law in assumpsit, brought by the holder of the certificate and power, for a refusal to permit him to make a transfer on the books, and the question of his legal title was necessarily involved in the case. The judgment therein must therefore be regarded as a direct adjudication that, as between the parties, the legal title to the shares will pass by delivery of the certificate and power. See 20 Wend., 362.

This was reasserted in this court in the *New Haven Railroad Case*, 34 N. Y. 80, notwithstanding what was said in the *Mechanics' Bank Case*, 13 id., 625.

"By omitting to register his transfer, the holder of the certificate and power fails to obtain the right to vote, and may lose his stock by a fraudulent transfer on the books of the company, by the registered holder, to a *bona fide* purchaser (34 N. Y. 80); but in this respect he is in a condition analogous to that of the holder of an unrecorded deed of land, and possesses a no less perfect title as against the assignor and others. And he would have an action against the corporation, for allowing such a transfer in violation of his rights. (Id.) He also takes the risk of the collection of dividends by his assignor, or of any lien the corporation may have on the shares. But in other respects his title is complete.

The holder of such a certificate and power, possesses all the external *indicia* of title to the stock, and an apparently unlimited power of disposition over it. He does not appear to have, as is said in some of the authorities cited, concerning the assignee of a chose in action, a mere equitable interest, which is said to be notice to all persons dealing with him that they take subject to all equities, latent or otherwise, of third parties; but, apparently, the legal title, and the means of transferring such title in the most effectual manner.

Such, then, being the nature and effect of the documents with which the plaintiff intrusted his brokers, what position does he occupy toward persons who, in reliance upon those documents, have in good faith advanced money to the brokers or their assigns on a pledge of the shares? When he asserts his title, and claims, as against them, that he could not be deprived of his

property without his consent, cannot he be truly answered that, by leaving the certificate in the hands of his brokers, accompanied by an instrument bearing his own signature, which purported to be executed for a consideration and to convey the title away from him, and to empower the bearer of it irrevocably to dispose of the stock, he in fact "substituted his trust in the honesty of his brokers, for the control which the law gave him over his own property," and that the consequences of a betrayal of that trust, should fall upon him who reposed it, rather than upon innocent strangers, from whom the brokers were thereby enabled to obtain their money?

These principals in substance, were applied in the case of *Kortright v. The Commercial Bank*. But it is sought to distinguish that case from this; and it is argued, that there the certificate was intrusted to an agent, with authority from his principal to borrow money upon it for the benefit of his principal, and that he simply exceeded his authority by borrowing more than he was authorized to borrow, and absconding with the excess.

The facts were, that the certificate indorsed by Barker, the owner of the shares, was sent by him, together with his note for \$10,000, to Bartow, the cashier of a bank in Albany, to obtain a loan of \$10,000. Bartow, through an agent in New York, negotiated a loan there, upon the certificate for \$25,000, and absconded. Barker admitted having received the \$10,000.

Whether the \$10,000 were to be, or were, borrowed by Bartow for Barker, or advanced by Bartow or his bank, does not clearly appear; and the opinions delivered in the case differ upon the point whether Bartow received the certificate as agent or pledgee. But, assuming that he received it as agent, the ground which lies at the foundation of the decision is, that the possession of the certificate and blank power, gave him an apparent right of control over the stock; that, if the holder of the certificate and power was exhibited to the money dealing public as having the competent right of pledge, disposal and transfer vested in him, by means of all the usual and well known evidences of such right, the private understanding of Barker and Bartow could not affect the rights of those who, if misled, were misled by Barker's own acts.

It is true that Senator Verplanck, in his prevailing opinion, cites authorities on the subject of a deviation by an agent from secret instructions, and treats the case as belonging to that class; but he also rests upon the more general principles above stated, and cites the well known case of *Pickering v. Busk*, 15 East, 38, where the owner had allowed a broker to be invested with the *indicia* of a legal title to goods, by a transfer of them into his own name on the wharfinger's books.

The principles of agency are, however, applicable to this case. In disposing of a pledge, the pledgee acts under a power from the pledgor. The distinction between a lien and a pledge is said to be, that a mere lien cannot be enforced by sale by the act of the party, but that a pledge is a lien with a power of sale superadded. Story on Bailments, 7th ed., § 311, note 2; *Wasson v. Smith*, 2 B. & Ald., 439. The pledgee in selling, is bound to protect the interests of the pledgor, and, as to the surplus, represents the pledgor exclusively. Now, for what purpose was the apparent ownership and power of disposition of this stock vested in the brokers? Surely for the purpose of enabling them effectually and summarily, to execute this power under certain conditions. If the power was absolute on its face, or if the whole legal title was by the instrument apparently vested in the pledgee, and the condition was secret, wherein does the case differ in principle from one of ordinary agency.

I am at loss to conceive on what principle it can be claimed, that an apparent naked authority is more effectual to bind the party giving it, than an apparent ownership as well as authority.

In the case of *Jarvis v. Rogers*, 13 Mass., 105, the shares were transferable by indorsement of the certificates. The shareholder indorsed his certificates and pledged them for a debt. The debtor's friend, by his authority, and with his funds, paid the debt and took up the certificates, and the debtor allowed them to remain thus indorsed, in his hands, but not for any specific purpose. This friend afterward pledged them for his own debt, to a party who advanced thereon in good faith. It was decided that the latter could hold them against the true owner.

The court, after distinguishing the case from one of mere bailment, says that after the plaintiff had put his name on the back of the certificates, and allowed them to go into the market with that transferable quality about them, it did not lie in the mouth of him who offered them to the world in that shape, to deny the effect of his own words and actions.

This decision was adhered to, and repeated in *Jarvis v. Rogers*, 15 Mass., 389, and recognizes substantially the same doctrine as *Kortwright v. The Com'l Bank*, omitting the element of excess by an agent, of authority actually given, which is supposed to have governed that case.

*Fatman v. Loback* 1 Duer, 354, is a case precisely in point, and I see no ground upon which the conclusions of the learned court in that case can be successfully assailed. The case of *McCready v. Ramsey*, 6 Duer, 574, which is cited as overruling *Fatman v. Loback*, has no such effect. The question in 6 Duer was between the assignee of the shares and the corporation,

and it was held that the lien of the corporation on the stock for unpaid subscription, was protected where the transfer was not made on the books, a position fully recognized in this opinion, and in the cases I have cited. Moreover in the case in 6 Duer, the general act under which the corporation was formed, provided that transferees of shares should take subject to the liabilities of prior shareholders.

In the cases of *Ex parte Swan*, 7 C. B. N. S. 400; *Swan v. The North British Australasian Co.*, 7 Hurl. & Nor., 603, and *Same v. Same*, 2 Hurl. & Coltman, 175, some of these questions received a most elaborate discussion, and there was a strong array of judicial opinions sustaining the validity of transfers of stock, unauthorized in point of fact on the ground that by mere negligence, and unintentionally, the true owner had enabled another to deliver an apparently valid title to the stock, and thus deceive third parties.

In that case, the plaintiff had intrusted to a broker ten deeds of transfer, executed in blank, for the purpose of transferring certain shares. The broker used only eight of them for the purpose intended, and feloniously filled up and used the others as transfers of other shares, belonging to the same party, forged the name of a subscribing witness, and stole the certificates of the shares from the plaintiff's box, of which the plaintiff kept the key. He then sold the shares to *bona fide* purchasers. He was convicted of the larceny.

In a contest by the owner to get back the shares, the Common Bench was, after two arguments, equally divided upon the question whether the owner was not estopped from reclaiming the shares, by reason of his negligence in intrusting the blank transfers to the broker, though they were intended for other shares. The case was taken to the Court of Exchequer, and that court was equally divided upon the same question. It was then taken to the Exchequer Chamber, where it was finally disposed of, principally on the ground, that to estop the owner, his negligence must be the proximate cause of the deceit. That here it was too remote, as the blank deeds of transfer were intended for other shares, and the broker had to commit forgery to make them available, and a separate felony to obtain possession of the certificates.

In the case at bar none of these difficulties exist. The assignment and power were intended for these identical shares; they, as well as the certificate, were voluntarily intrusted by the plaintiff to the brokers, and the latter were thus invested with the apparent ownership and right of disposal, not merely by the negligence of the true owner, but by his voluntary act, and for the very purpose of attesting to the world their title and power, in

case the contingency should arise, in which, according to the understanding between them and the plaintiff, they would be justified in resorting to the stock for their own indemnity.

Two cases have been cited on the part of the respondent which require notice, viz.: *Covell v. The Tradesmen's Bank*, 1 Paige, 131, and *Bush, Administrator v. Lathrop*, 22 N. Y., 535.

In *Covell v. The Tradesmen's Bank*, the complainant, being the owner of a sealed note for \$2,425, payable to himself, indorsed it and pledged it to M. for a loan of \$1,000. M. indorsed it and pledged it to the bank, defendant, as security for an antecedent debt of \$1,000 and a fresh advance of \$1,425. The complainant's debt to M. having been paid, he filed his bill against the bank and M. to obtain a surrender of the note.

The chancellor disposed of the case on the ground that the sealed note, being a mere chose in action, was not assignable in law. That the assignee of a chose in action, which must be sued in the name of the assignor, obtains only an equitable interest, the legal title remaining in the assignor; and that the interest of such assignee, being only equitable, was not protected against the prior equity and legal right of the original owner. Thus applying to the assignee of a chose in action the doctrine which he afterward, in the case of *Kortright v. The Commercial Bank*, unsuccessfully sought to apply to the transferee, by assignment and power, of shares of stock in a corporation.

He refers to the decision of Chancellor Kent, in *Murray v. Lyburn*, 2 Johns. Ch., 443, to the effect that the assignee of a chose in action takes subject only to the equities of the debtor, and not subject to latent equities of a third person against the assignor, and points out that the case of *Redfern v. Ferrier*, 1 Dow's Par. R., 50, cited by Chancellor Kent, was decided, not on the ground that the assignee of a chose in action was protested against a latent equity in a third person, but that a share in a joint-stock company was not a chose in action; that the assignee had, according to the law of Scotland, the legal title to the shares, and that the equities of the parties being equal, the court would not divest him of his legal right.

In *Bush, Administrator v. Lathrop*, 22 N. Y., 535, the plaintiff's intestate, being the assignee of a bond and mortgage for \$1,400, pledged them to Preston to secure \$268.20, and delivered them to the pledgee with a note for the amount, and an assignment of the bond and mortgage, absolute on its face, but expressing a consideration of only \$268.20, the mortgage being good for its full amount. Preston gave back a receipt, agreeing to redeem the bond and mortgage on payment of the note.

Preston afterward assigned the bond and mortgage to Smith & Norton, who in turn assigned to the defendant for \$1,488, advanced by him in good faith. The plaintiff brought his action, to obtain a retransfer of the bond and mortgage on payment of the \$268.20, with interest.

Denio, J., in delivering the opinion of the court, reviews the decision of Chancellor Kent, in *Murray v. Lylburn*, and other cases, on the subject of latent equities, disapproving of the doctrine of Chancellor Kent, and coming to the conclusion, that an assignment of a chose in action takes but an equitable interest, notwithstanding the provisions of the Code which authorize him to sue in his own name. That all the assignees of the bond and mortgage in question, subsequent to the original obligee, must be regarded as holding merely equitable interests, and that, as between parties so circumstanced, priority of time confers a preferable right, 22 N. Y. R., 547, 548, following, substantially, the opinion of Chancellor Walworth in *Covell v. The Tradesmen's Bank*, which he cites.

He concedes that this doctrine forms a serious impediment to his negotiation of choses in action, and alludes to the difference of opinion which may exist as to the policy of encouraging their negotiation, and to the period when it was thought so impolitic, that courts of law would not recognize the rights of assignees. But in no part of his learned and exhaustive opinion, does he seek to apply its doctrine to shares in corporations, or other personal property, the legal title to which is capable of being transferred by assignment, and the free transmission of which, from hand to hand, is essential to the prosperity of a commercial people.

The question of estoppel does not seem to have been considered in that case; and perhaps it would have been inappropriate, inasmuch as the assignment upon which the estoppel could have been predicated, if at all, expressed a consideration of only \$268.20 for a good mortgage of \$1,400; a circumstance calculated to excite inquiry. But it is sufficient for all present purposes to say, that the reasoning upon which the decision in that case is founded, is totally inapplicable to this.

I have reviewed the authorities at much more length than usual, by reason of the difference of opinion expressed in the late Court of Appeals in this case, and for the purpose of meeting the positions, so ably maintained in the opinions, in favor of the respondent, delivered in the court below, and in the late court, on the former hearing.

My conclusion is that the Tenth National Bank must, on the facts found, be deemed to have advanced *bona fide* on the credit of the shares, and of the assignment and power executed by the



plaintiff, and is entitled to hold the stock for the full amount so advanced, and remaining unpaid after exhausting the other securities received for the same advance.

The points relative to the stamp and subscribing witness were fully answered in the opinions delivered on the first argument, and do not appear to have been the subject of dissent. I do not deem it necessary again to discuss them here.

The judgment of the General Term, and that entered on the report of the referee, should be modified, so as to allow the plaintiff to redeem, on payment of the balance due to the Tenth National Bank, on its advance of June 19th, 1868, and the costs of the action.

All concur except Allen and Folger, JJ., not voting.  
Judgment modified.

## CHAPTER XIV.

## CORPORATE MEETING.

## BJORNGAARD V. GOODHUE COUNTY BANK.\*

SUPREME COURT OF MINNESOTA, 1892.

(59 Minn. 483)

*Right to Vote at Stockholders' Meeting—Personal Interest in  
Matter Under Consideration.*

Gilfillan, C. J.: The defendant bank is a banking corporation. The defendants, Sheldon, Perkins, Featherstone, Brooks, Boxrud and William, and Frederick Busch, and the plaintiff Hoyt, were at the times hereinafter mentioned, and now are, its directors. The director defendants were and are stockholders, owning a large majority of the stock. The plaintiffs are stockholders. The defendant stockholders owned a lot and building. At a directors' meeting on July 7, 1890, all the directors being present, it was resolved, all the directors except Hoyt, who protested, voting in the affirmative, that the corporation purchase at a price specified said lot and building, and on July 11, the owners executed a conveyance to the bank. The action is brought to set aside the transaction, and to prevent the funds of the bank being used to complete the purchase, and also to prevent a ratification by the stockholders, a meeting of whom had been called for the purpose, or, rather, to prevent such a ratification by the votes of defendants. There is no doubt that, within the rule in *Rothwell v. Robinson*, 39 Minn. 1, 38 N. W. Rep. 772, the plaintiffs may bring such an action without first applying to the corporate

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\* "A contract entered into by a corporation, by the authority or direction of its trustees as with themselves, and for their benefit, or a transfer of its property by the authority to the trustees to themselves may be set aside, in case it injures any public interest or the private interest of any shareholder or creditor, even though the contract or transfer was executed in good faith by the trustees. *Duncomb v. Railroad Co.*, 84 N. Y. 190. But this rule is not broad enough to condemn as void on the ground of public policy all contracts and transfers executed by a purely private business corporation with or to its trustees in good faith, in case no public or private interest is harmed thereby. Such contracts are not void, but voidable at the election of those who are affected by the fraud." *Skinner v. Smith*, 184 N. Y. 240, per Follett, C. J., citing *Oil Co. v. Marbury*, 91 U. S. 587; *Thomas v. Railroad Co.*, 109 U. S. 522; *Risley v. Railroad Co.*, 62 N. Y. 240; *Barnes v. Brown*, 80 N. Y. 527; *Munson v. Railroad Co.*, 108 N. Y. 58; *Barr v. Railroad Co.*, 125 N. Y. 263.

authorities to bring it. The directors against whom complaint is made, are not only a majority of the directors, but they own a majority of the stock, so that any application either to the board of directors or to the body of stockholders to bring the action would be equivalent to asking the alleged wrongdoers to bring suit in the name of the corporation against themselves. The law does not require of the minority stockholders to do so absurd a thing as a condition of seeking relief against the wrongful acts of the directors and majority stockholders. The court below decided the case in favor of the defendants on the proposition that, although the act of the board of directors was voidable, it was not *ultra vires*, and was capable of ratification; and where a majority of the stockholders have power to ratify the unauthorized act of the directors, courts will not interfere. We see no reason to think this purchase was *ultra vires*,—that the corporation had not power to make it. And, that being so, it may be conceded that the board of directors had authority to make a purchase for the corporation. And it is undoubtedly true that, where a corporation has power to do a certain thing, though the authority to do it is not in the directors, the stockholders may ratify their act if they assume to do it on behalf of the corporation. But this transaction is not voidable because *ultra vires*,—because there was no authority in the directors to purchase; but it is voidable under the rule that one having authority from another to purchase or sell for him cannot purchase from nor sell to himself. To do so is in law a fraud. The rule is absolute, and the matter of fraud in fact is immaterial. The party for whom the purchase or sale is made need not allege nor prove fraud or injury but may disaffirm without taking any risk. The rule is inflexible, in order to prevent fraud on the part of one holding a fiduciary relation, by making it impossible for him to profit by it, thus removing temptation from his way. This court has steadily adhered to and applied the rule since it first enunciated it in *Baldwin v. Allison*, 4 Minn. 25, (Gil. 11.) But in all cases of the kind the principal may, with full knowledge of the facts, ratify what has been done. The act of the defendant directors was a violation of this rule, and the purchase was not binding on the corporation until ratified. The question is therefore presented under the allegation and relief asked in the complaint, had the defendants a right to vote as stockholders at the stockholders' meeting called for the purpose upon the question of ratification? While stockholders in a corporation owe the duty of good faith to each other in the management of the affairs of the corporation they do not stand to each other in a fiduciary relation within the rule we have stated. They are not trustees nor agents for each other in the matter of voting upon any proposition that may come before a meeting of the

stockholders. In voting, each must be guided by his own judgment as to what is for the best interest of the corporation. The fact that he may have a personal interest, separate from the others or from that of the corporation in the matter to be voted upon, does not affect his right to vote. It is not to be understood that the majority stockholders may use their power of voting for the purpose of defrauding the minority. It was said in *Gamble v. Queens Co. Water Co.*, 123 N.Y. 91, 25 N.E. Rep. 201, in which the right of a stockholder in such a case to vote was affirmed: "In such cases it may be stated that the action of the majority of the shareholders may be subjected to the scrutiny of a court of equity at the suit of the minority shareholders." And in *Transportation Co. v. Beatty, L. R.*, 12 App. Cas. 589, in which the same thing was held, it was said, in effect, that in such case the ratification must not be brought about by unfair or improper means, nor be illegal or fraudulent or oppressive towards those shareholders who oppose it. A rule excluding stockholders from the right to vote merely because they might be personally interested to vote in a particular way, contrary to the interests of the other stockholders, would be likely to lead to great confusion. The rule laid down in the two cases cited is sufficient to secure the exercise of the good faith which one stockholder owes to the others.

Judgment affirmed.

## CHAPTER XV.

## OFFICERS AND AGENTS.

## NORTH HUDSON BUILDING &amp; LOAN ASS'N V. CHILDS.\*

SUPREME COURT OF WISCONSIN, 1892.

(62 N. W. Rep. 600.)

*Liabilities of Directors for Negligence and Misfeasance.*

Pinney, J.: 1. The corporation plaintiff has a remedy against its directors and officers for negligence, fraud, breaches of trust, or for acts done in excess of their authority, and the case against each is distinct, depending upon the evidence against him, unless two or more have joined or participated in the wrongful act, in which case all participants may be joined in the suit. And where the act is illegal, or in violation of some positive law, the authorities indicate that there is no right of contribution where one only is sued and charged; and therefore it is held in many cases that it is not necessary to make all the directors parties who have more or less joined in the act complained of. Thomp. Liab. Off. in notes 352, 353, 411, and cases cited. A different rule is maintained in the modern cases in England and America, in cases where the wrongful act is the result of negligence or gross misjudgment, and is not, in and of itself, illegal, or a violation of some positive law, as will be shown hereafter; and there exists high authority in such cases for holding that, in all cases where contribution would be allowed in equity, there those who are liable to contribute are necessary parties to a suit in equity to obtain redress for the loss which the corporation has suffered. The remedy of the corporation for the wrong done is either at law or in equity, according to the nature of the case. Hence, in every such case as the present, it is important to determine at the outset whether the action shall be or is a legal or equitable one, and, if the latter, whether the necessary parties are before the court, to enable it to make a proper and complete determination of the controversy. This action has been treated throughout by the plaintiff and by the circuit court as a legal action, both in the demand for judgment and in the course taken at the trial, a trial

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\*Horn Silver Mining Co. v. Ryan, 42 Minn. 196.

by jury having been waived, and the court ruling that no evidence of liability was competent that did not equally affect both defendants; and, after judgment by the remission of damages for the periods mentioned, on the ground that for these sums the defendants were not jointly liable, though this fact was either overlooked or was not regarded in the decision of the case.

2. The complaint is not entirely definite and clear in the allegations upon which the liability of the defendants is rested, but groups together grounds, not entirely congruous, when stated in the same cause of action, as the charge against them is gross neglect, mismanagement, and inattention of the defendants "to the duties of their said offices," and they are, to some extent, at least, attempted to be charged for negligence or misconduct in their respective offices of president and treasurer, and also as members of the board of directors, the by-laws making them *ex officio* such. Some of the acts as to which negligence and misconduct are predicated lie wholly outside the scope of the duties of either one or both the president and treasurer. In the main, the *gravamen* of the case seems to be that the defendants have exceeded their respective powers as such president and treasurer in dealing with the property and property rights of the plaintiff, and have usurped the powers of the board of directors in these respects; and it is expressly charged in the 7th, 9th, 10th, 11th, 12th, 13th, and 14th "causes of action" (so designated) that they did the acts complained of "without the knowledge, consent, and approval of the board of directors;" and the last of these causes of action, grouping the plaintiff's losses in one aggregate sum of \$22,000, charges "that between the 1st of March, 1882, and the 1st of September, 1887, the plaintiff, through the gross neglect, mismanagement, and inattention of the defendants to the duties of their said offices, has lost in dues, interest, and charges on stocks and loans, and on loans made by defendants, and in the wrongful cancellation of stock by the defendants, and paying thereon more than the holders thereof were entitled to receive and be paid by said corporation, and without the knowledge, consent, or authority of the board of directors of said corporation, and without the knowledge, consent, or authority of the stockholders thereof, to the amount of \$22,000." The first five "causes of action" (so designated) proceed entirely upon the ground of gross neglect and mismanagement of the defendants, and there are items also in the other causes of action based on that ground. The circuit court based the finding against the defendants on the ground "of gross negligence and usurpation of authority not given them by the by-laws but reserved to the board of directors." These different allegations thus blended in the several so-called "causes of action,"

which are in fact but enumerations of items of liability under what is really but one general count, require different answers and different evidence to meet them, creating difficulties of procedure which can be best dealt with and overcome in an equitable action. We think that the case made by the pleadings and proofs is not one where an adequate and proper remedy by legal action can be obtained, but the action must be treated as an equitable one; and that the circuit court erred in dealing with it on any other basis. As a recovery in a legal action, the judgment must stand or fall on the liability of the defendants as president and treasurer, for no recovery can be had at law against a minority of the board of directors for misconduct or negligence, inasmuch as they can act only when lawfully assembled, and their duties as such are devolved on them as a board, and not individually. *Insurance Co. v. Jenkins*, 3 Wend. 134; *Gaffney v. Colvill*, 6 Hill, 572, 573.

3. Much argument was had upon the rule of liability of corporate officers in cases such as this, presenting for consideration some questions in respect to which a considerable difference of opinion has prevailed. The liability of officers to the corporation for damages caused by negligent or unauthorized acts rests upon the common-law rule, which renders every agent liable who violates his authority or neglects his duty to the damage of his principal. It seems to be now universally agreed that, no matter, whether the act is prohibited by the charter or by-laws, the liability is on the ground of violation of authority or neglect of duty. *Thomp. Liab. Off.* 357; *Briggs v. Spaulding*, 141 U. S. 146, 11 Sup. Ct. Rep. 924. There can be no doubt that, if the directors or officers of a company do acts clearly beyond their power, whereby loss ensues to the company, or dispose of its property or pay away its money without authority, they will be required to make good the loss out of their private estates. *Thomp. Liab. Off.* 375; *Discount Co. v. Brown*, L. R., 8 Eq. 381; *Flitcroft's Case*, 21 Ch. Div. 519; *Insurance Co. v. Jenkins*, 3 Wend. 130,—and many other authorities to this effect were cited by the respondent's counsel. This is the rule where the disposition made of money or property of the corporation is one either not within the lawful power of the corporation, or, if within the power of the corporation, is not within the power or authority of the particular officer or officers. Where the ground of liability, is for nonfeasance, negligence, or misjudgment in respect to matters within the scope of the proper powers of the officer, he will be held responsible only for a failure to bring to the discharge of his duties such degree of attention, care, skill, and judgment as are ordinarily used and practiced in the discharge of such duties or employments; the degree of care, skill, and judgment depend-

ing upon the subject to which it is to be applied, the particular circumstances of the case, and the usages of business. In respect to directors, or those acting *ex officio* as such, the rule of liability has been the subject of much discussion in the recent case of *Briggs v. Spaulding*, 141 U. S. 132, 11 Sup. Ct. Rep. 924, in which, although there was a strong dissent, the rule may be regarded as settled, in the federal courts, at least, and in the courts of several of the states, as there laid down, and to the effect that directors, although often called "trustees," are not such in any technical sense, but that they are mandataries, the relation between them and the corporation being rather that of principal and agent, but under circumstances they may be treated as occupying, in consequence of the powers conferred on them, the position of trustees to *testuis que trustent*; that the degree of care required of them depends upon the subject to which it is to be applied, and each case is to be determined upon its own circumstances; that, as they render their services gratuitously, they are not to be held to the degree of responsibility of bailees for hire, or expected to devote their whole time and attention to their duties; that they are not, in the absence of any element of positive misfeasance, and solely on the ground of passive negligence, to be held liable, unless their negligence is gross, or they are fairly subject to the imputation of a want of good faith. It is to be remembered that they have the same interests to protect and subserve as other stockholders, and self-interest naturally prompts them to look after their own, and the degree of care they are bound to exercise is that which ordinarily prudent and diligent men would exercise under similar circumstances in respect to a like gratuitous employment, regard being had to the usages of business and the circumstances of each particular case; that they are not liable, in the absence of fraud or intentional breach of trust, for negligence, mistakes of judgment and bad management in making investments on doubtful or insufficient security. Where they have not profited personally by their bad management, or appropriated any of the property of the corporation to their own use, courts of equity treat them with indulgence. Were a more rigid rule to be applied, it would be difficult to get men of character and pecuniary responsibility to fill such positions. *Thomp. Liab. Off.* 357; *Beach, Corp.* § 249. These views are sustained in *Briggs v. Spaulding*, *supra*; *Spering's Appeal*, 71 Pa. St. 1; *Association v. Coriell*, 34 N. J. Eq. 383, 392; *Swentzel v. Bank*, (Pa. Sup.) 23 Atl. Rep. 413; *In re Dean Coal Min. Co.*, 10 Ch. Div. 450; *Ackerman v. Halsey*, 37 N. J. Eq. 363; *Hun v. Cary*, 82 N. Y. 65; *In re Denham*, 25 Ch. Div. 752; *Watt's Appeal*, 78 Pa. St. 391. These views are applicable, we think, to the case of all officers serving and acting within the scope of their



authority gratuitously, or practically so. The rule of liability in case of service for reward is well understood, and need not be repeated. It has been thought best to indicate the rules we think applicable to the liability of directors and other officers of corporations, as these questions were fully discussed at the argument, and in view of the probable importance of these questions in the future disposition of this cause.

The finding of the circuit court that no directors' meetings were held within the period mentioned, and that the business of the corporation, consisting of issuing stock, making loans, accepting prepayment of loans, and in fact all the business of the corporation, was transacted without any direction of the board of directors by the defendants and Harvey, the secretary, since deceased, is, we think, sustained by the evidence, although stoutly denied by the defendants. There is not only no record of any such meetings, but those who are said to have been directors during the period all deny attending any such meetings or transacting any such business, and the defendants themselves are wholly unable to name a single director who was present at any such meeting. While the absence of a record of proceedings, due to the negligence of the secretary, would not defeat the action of the directors, we are satisfied no such meetings were held, and that the alleged want of authority in respect to many matters transacted by the defendants, or one of them, and Harvey, was not supplied at any of the stockholders' meetings, and, unless ratified subsequently, they were without requisite authority. During a period of about five years the regularly chosen directors of the corporation wholly abdicated their functions as such, and gave no attention whatever to their duties, and left everything connected with the affairs of the corporation to the management of the president, secretary, and treasurer, by virtue of their several offices, and, beyond this, to take their own unheeded course. At the annual meetings of stockholders, officers and directors were regularly elected, and reports were made by the secretary and treasurer, but the directors elected utterly neglected their duties as before. The death of Harvey caused investigation, when the entire absence of proper entries on the ledger and record during all this period was discovered, as well as the fact that there was a shortage in the funds of the corporation. The defendants during all this time had proceeded to discharge the duties of their respective offices, and looked after and conducted the affairs of the corporation in connection with Harvey, the secretary, in entire good faith, not deriving any improper personal gain or profit, and without improperly appropriating to themselves any of its property or funds. They may have made mistakes and misjudged as to their powers and duties. They were not guilty of intentional wrong. The de-

defendant Denniston, the treasurer, whose functions were purely ministerial, and extended only to receiving the moneys of the plaintiff and paying them out, and to the safe-keeping of its securities, and keeping a correct account, has accounted for and paid over every cent he received, and yet he was charged by the circuit court with losses of the corporation by the judgment in this case to the amount of over \$21,000. We are unable to see how the defendants are to be thus charged as *ex officio* members of the board. They were not technically directors, and neither of them had it in his power to call a meeting of the board. They could act as *ex officio* members only at a meeting regularly convened, and no meetings were held. Directors cannot act in any other manner. Cook, Corp. § 592, and cases in note. This is so well settled that citations of authority would be superfluous. Stated monthly meetings of the board were required to be held on the next Tuesday after the monthly stockholders' meetings, but the directors came not. Special meetings might be called on the written request of two directors, but no such request appears to have been made, and none are willing to own, now that misfortune has overtaken the company, that he ever acted as a director during the period in question. All have been eager to take the benefits, whatever they were, of the management of the defendants, and accept their share of the money disbursed in paying off the first series of stock at a figure amounting to nearly \$8,000 more than was due on it, as it is now claimed. None but the president, treasurer, and secretary appear to have been willing to give the affairs of the corporation any particular attention. And at least five of the directors are understood to have received, and still hold, their shares of this amount, and now all appear to be demanding that these defendants shall put back that amount of money from their own funds into the treasury of the plaintiff to make good the alleged loss on this and other accounts, arising out of their attempt to manage the affairs of the plaintiff without the aid or authority of the board of directors. Such a claim, when well founded in law, ought to be established by entirely satisfactory evidence. Regarding the case now presented by the record as one where a recovery must depend upon the liability of the defendants disconnected with their *ex officio* membership of the board, it is plain that Childs and Denniston, in their respective capacities as president and treasurer, are not responsible for the nonfeasance, negligence, or misfeasance of Harvey, as secretary; nor is either of these liable for the nonfeasance, negligence, or misfeasance of the other in his official relations to the plaintiff. Their liability is several and separate. They cannot be held jointly liable for any act in excess of the authority of either, or both of them, without proof of joint participation, to be proved.

in each instance, and not presumed; and here we have neither finding nor proof of improper combination or intentional wrong. If Childs and Harvey, as president and secretary, exceeded their powers in any given instance to the loss or damage of the plaintiff, Denniston is not chargeable with it, without proof that he intermeddled with it and in excess of his authority. If Denniston and Harvey, as treasurer and secretary, exceeded their powers in any case to the loss or damage of the plaintiff, Childs is not liable without proof that he intermeddled or participated in the wrong. While these rules are obviously correct, and so clearly so that citation of authority is not needed to vindicate them, in view of the finding and the evidence upon which it was based we have felt it proper to state them at length, and with some particularity, as bearing upon the correctness of the judgment of the circuit court.

4. It is contended by the respondent that, as no motion for a new trial was made before judgment, the question whether the finding is contrary to evidence is not open to review. As the trial was by the court without a jury, no such motion was necessary. Where there are exceptions to the finding, this court must review the case on the facts. *Garbutt v. Bank*, 22 Wis. 377.

5. The extent of loss or damages the plaintiff had sustained formed a very important part of the controversy, and upon this branch of the case we regret to say that we are without the assistance and benefit of an examination and determination of the circuit court. As early as September, 1887, the plaintiff employed a Mr. Somers, of St. Paul, as an expert accountant, who had had considerable experience in the management of the affairs of building associations, to examine the books and papers of the plaintiff, ascertain its financial condition, the extent of its losses, and how they had been occasioned. His examination extended from February, 1882, to September, 1887. He made a report upon these matters, which was put in evidence on the trial, or the substance of it, and this report, with a set of books compiled by him, and his testimony, constitute almost the entire basis on which the finding against the defendants for \$21,407.05 rests. This report was adopted as an entirety by the circuit court, and the question of the extent of loss or damages, as well as legal questions in respect to liability, were, in effect, determined by the hired expert of the plaintiff, instead of the court; and we have been urged to accept it here in like manner as final and conclusive. If we were willing to do so, and should accordingly affirm this judgment, it would transpire that the plaintiff's expert had practically decided this important cause in both courts on several vital and important questions of law as well as fact. We cannot suppose that the circuit court, if it had examined the report,

would have rendered the judgment found in the record. It was not the duty of the defendant Denniston, as treasurer, to collect the first five items in the foregoing statement, amounting to nearly \$3,000; nor was it the duty of Childs, as president, so far as we are able to understand it. The treasurer is only "to receive all moneys as soon as paid into the association." The secretary has custody of the accounts, books, and papers of the corporation, except deeds, bonds, mortgages, etc., kept by the treasurer, and is, it would seem, the executive manager of the financial business of the corporation. The testimony to show that any loss had been actually sustained while these defendants were in office is too vague and uncertain to justify the rendition of a judgment for these amounts. Mere proof of failure to collect these items is far from showing that they were lost. Besides, as to many of them, their collection might have been enforced by forfeiture and sale of the stock. These defendants did not possess that power. It was lodged with the board of directors, and in some instances at least the security for loans is security for fines, dues and interest. The collection of these items was a part of the business of the corporation in charge of its board of directors, and they might devolve it on the secretary, if it was not one of the duties of his office, as we understand it was. It is quite as consistent with the evidence that these losses, if such there were, occurred after the defendants resigned as before.

There is nothing in the by-laws nor in the evidence to show that it was the duty of the treasurer to do anything in relation to issuing stock beyond caring for the money paid for it after it was "paid into the association." His duties were purely ministerial, and he had nothing to do, as treasurer, with determining or computing the amount to be paid on the issue of stock, nor is there any testimony showing or tending to show that he ever assumed to interfere with any such matter. It was error, therefore, to include in a judgment against him the sum of \$112.06 for losses on shares issued for too little money. Nor is there, so far as we can discover, any proof tending to show that this loss was the fault of the president, whose duty it is to sign stock certificates.

There is embraced in the judgment items to the amount of about \$6,800 for losses by cancellation of loans on the ground that there was not money enough paid on them to satisfy them. These items appear, from Mr. Somers' testimony, to have been arrived at by ascertaining the amount of securities canceled each year during the period in question, and by deducting therefrom the amount that "appears to have been paid on that account as per secretary's report," and the difference is charged up as a loss for which the defendants are held liable. The secretary's report is not competent evidence against these defendants to charge

them with this supposed loss. It is not evidence that no more was paid to him than he reported. Which of these defendants, if either, attended to the matter of settling up the loans upon which the alleged losses occurred, we are unable to ascertain from the evidence; and if in some cases Denniston did, and in others Childs, we have no *data* upon which to ascertain the amount for which either ought to be charged. An exhibit annexed to the bill of exceptions would seem to show that in some instances releases of mortgage loans were executed and acknowledged by Childs as president, and in some cases by Denniston as treasurer, but in all cases by Harvey as secretary. If loss occurred as charged, the evidence is not sufficient to show it, much less to show what sum should be charged to Childs, and what to Denniston. It seems to have been assumed throughout that, if either Childs, Harvey or Denniston exceeded his authority as an officer, and loss ensued, the other two would necessarily be liable for it by reason of the assumption by the one of authority lodged only in the board of directors. Each of these parties, in the absence of participation of one or both the others, would alone be liable for exceeding his authority.

The testimony as to items amounting to \$3,500, or thereabouts, for losses by reason of money having been paid for cancellation of stock in excess of its value seems to rest upon some method of ascertaining its supposed value adopted by Somers, which we do not fully understand; and the same is true as to cancellation of loans. He seems to have adopted some rule differing from the by-law of the company on that subject. He testified that the different parts of the rule, which is quite obscure, "don't hang together." But, in view of the result at which we have arrived, it is not necessary to carefully examine this matter.

6. Stock was issued by the corporation in five series: First series, March 28, 1877, 500 shares; second series, March, 1879, 172 shares; third series, March, 1880, 76 shares; fourth series, March, 1883, 116 shares; and fifth series, February, 1886, 125 shares. It was generally supposed that the first series had matured so as to be payable at twice its nominal value in September, 1885, and the officers, Childs, Denniston and Harvey, proceeded to make quite a large loan of the First National Bank of Hudson to raise money to pay off that series accordingly, and pledged to the bank a large amount of the plaintiff's securities; the defendant Denniston indorsing the note given for the loan. There was a general understanding that the first series was to be paid off, and the stockholders were anxious and ready to receive their money. Payments were accordingly made by the treasurer on orders drawn by Harvey, as secretary, and signed by Childs, from time to time, until Harvey's death in March, 1887, no one

making any objection, or supposing, so far as the evidence shows, that there was any apprehension of any shortage in the funds of the corporation, or any irregularity in the management of its affairs. The defendants, up to this time, supposed Harvey had kept the books and records properly. Investigation ensued, and suit was brought against the bank by the plaintiff to recover its securities pledged for the loan. In the mean time a board of directors and other officers had been chosen, and the corporation had been rehabilitated and restored to its normal action, and payments had been ordered to be made, and were in fact paid, on this loan. The plaintiff was unsuccessful in its suit against the bank, and it finally paid the loan. The new board had voted to pay six per cent. interest in May, 1887, on all unpaid claims under the first series of stock, and directed the issue of orders to pay some of the claimants under this series, on the basis that it had matured in September, 1885, and as late as January 11, 1888, two orders were directed to be issued for the payment of some shares on the same basis. The question had been mooted in the previous summer and fall whether the first series had matured, and whether the shortage in the funds was not caused by paying off that series at much more than its actual value. The result was that as early, probably, as September, 1887, and soon as Somers had made his report, the plaintiff set up the claim that at the time the first series of stock was paid off it was in fact worth only \$1.49, instead of \$2, as had been supposed, basing the claim on such report. The item included in the judgment on this account is a large one, and is sustained only by the report or opinion of Mr. Somers, and the argument made upon the *data* furnished by his report and the evidence tends strongly to show that the stock was worth much more than the estimate made by him. The accuracy and justice of his report as a basis of judicial action against these defendants have been found so seriously at fault, and as they were not made the subject of judicial examination and consideration in the circuit court, as it ought to have been, we cannot accept and act on his conclusions in respect to the claim that the first series of stock was worth only \$1.49 when paid off. It is not within our province or duty to enter upon this inquiry until it has been examined and passed on by the circuit court.

We think that, inasmuch as the action was treated as a legal, and not an equitable, one, by the circuit court, and as the correctness of the report or statement of the expert, Somers, was not judicially investigated and passed on, there was practically a mistrial of the action, and that the judgment should be reversed on that ground, if for no other reason. "A trial is the judicial examination of the issues between the parties." Rev. St. § 2842.

We have bestowed an unusual amount of care and labor upon this important case, and have been desirous, if possible, to arrive at some conclusion upon which we might direct such judgment to be entered as we might feel confident would do substantial justice to the parties, and avoid the delay and cost of further litigation, but we have been unable to do so with the material before us. The functions of this court, with few exceptions, are appellate only. We cannot permit the burden of the duty of trial courts to examine and pass upon cases before them to be cast upon us in the first instance, without proper opportunity for such examination, burdened as we are with a constantly increasing number of appeals. We cannot stop, if we were disposed to do so, to enter into elaborate computations and comparisons, and examine critically voluminous bills of exceptions, with numerous manuscript exhibits, sometimes supplemented with a box filled with books and papers. All this great bulk of matter should be reduced to reasonable compass, and arranged in proper order, before being brought to this court. As the judgment of the circuit court must be reversed for the errors already noticed, we think it is but justice to both parties to order a new trial, and to direct that the cause be referred upon all the issues therein, upon the proofs already taken and such as may be produced hereafter, to some attorney being a competent accountant, to report special findings upon all the issues, and to take and state an account of the transactions in question, and report the same to the court, to the end that such judgment may be rendered thereon as shall be just and proper. The action must be regarded as an equitable one, and ot er necessary or proper parties may be brought in, if it be deemedh necessary by the plaintiff or by the court, in order to secure a just and proper determination of the entire controversy. If it shall be thought proper to amend the pleadings so as to charge these defendants in equity as *ex-officio* members of the board of directors, it may be that all the directors during the period in question will be necessary parties, (*Sherman v. Parish*, 53 N. Y. 483,) on the ground that the defendants, if chargeable as such, are entitled to have contribution of and from such directors. (*Nickerson v. Wheeler*, 118 Mass. 295; *Baynard v. Woolley*, 20 Beav. 584; *Ashhurst v. Mason*, L. R., 20 Eq. 225, 236.) There are authorities which take a contrary view, and, as these questions, thus suggested, were not argued at the hearing, we do not express any opinion in respect to them. The question whether the corporation plaintiff has not so far taken and enjoyed the benefits of the transactions complained of, and ratified them, that it has lost the right to complain of them, was ably and vigorously pressed upon our attention, but we express no opinion on

this point, as additional evidence may be produced materially affecting the rights of the parties in respect to it. The judgment of the circuit court is reversed, and the cause is remanded for a new trial, and for further proceeding in accordance with the opinion of this court.

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McARTHUR V. TIMES PRINTING CO.

SUPREME COURT OF MINNESOTA, 1892.

(48 Minn. 319.)

*Contracts Made by Promoters—Adoption by the Corporation.*

Mitchell, J.: The complaint alleges that about October 1, 1889, the defendant contracted with plaintiff for his services as advertising solicitor for one year; that in April, 1890, it discharged him in violation of the contract. The action is to recover damages for the breach of the contract. The answer sets up two defenses: (1) That plaintiff's employment was not for any stated time, but only from week to week; (2) that he was discharged for good cause. Upon the trial there was evidence reasonably tending to prove that in September, 1889, one C. A. Nimocks and others were engaged as promoters in procuring the organization of the defendant company to publish a newspaper; that, about September 12th, Nimocks, as such promoter, made a contract with plaintiff, in behalf of the contemplated company, for his services as advertising solicitor for the period of one year from and after October 1st,—the date at which it was expected that the company would be organized; that the corporation was not, in fact, organized until October 16th, but that the publication of the paper was commenced by the promoters October 1st, at which date plaintiff, in pursuance of his arrangement with Nimocks, entered upon the discharge of his duties as advertising solicitor for the paper; that after the organization of the company he continued in its employment in the same capacity until discharged, the following April; that defendants board of directors never took any formal action with reference to the contract made in its behalf by Nimocks, but all of the stockholders, directors, and officers of the corporation knew of this contract at the time of its organization, or were informed of it soon afterwards, and none of them objected to or repudiated it, but, on the contrary, retained plaintiff in the employment of the company without any other or new contract as to his services.



There is a line of cases which hold that where a contract is made in behalf of, and for the benefit of, a projected corporation, the corporation, after its organization, cannot become a party to the contract, either by adoption or ratification of it. *Abbott v. Hapgood*, 150 Mass. 248, 22 N.E. Rep. 907; *Beach, Corp.* § 198. This, however, seems to be more a question of name than of substance; that is, whether the liability of the corporation, in such cases, is to be placed on the grounds of its adoption of the contract of its promoters, or upon some other ground, such as equitable estoppel. This court, in accordance with what we deem sound reason, as well as the weight of authority, has held that, while a corporation is not bound by engagements made on its behalf by its promoters, before its organization, it may after its organization make such engagements its own contracts. And this it may do precisely as it might make similar original contracts; formal action of its board of directors being necessary only where it would be necessary in the case of a similar original contract. That it is not requisite that such adoption or acceptance be express, but it may be inferred from acts or acquiescence on part of the corporation, or its authorized agents, as any similar original contract might be shown. *Battelle v. Northwestern Cement and Concrete Pavement Co.*, 37 Minn. 89, 33 N. W. Rep. 327. See also *Mor. Corp.* § 548. The right of the corporate agents to adopt an agreement originally made by promoters depends upon the purposes of the corporation and the nature of the agreement. Of course, the agreement must be one with the corporation itself could make, and one which the usual agents of the company have express or implied authority to make. That the contract in this case was of that kind is very clear; and the acts and acquiescence of the corporate officers, after the organization of the company, fully justified the jury in finding that it had adopted it as its own.

The defendant, however, claims that the contract was void under the statute of frauds, because, "by its terms not to be performed within one year from the making thereof," which counsel assumes to be September 12th,—the date of the agreement between plaintiff and the promoter. This proceeds upon the erroneous theory that the act of the corporation, in such cases, is a ratification, which relates back to the date of the contract with the promoter, under the familiar maxim that "a subsequent ratification has a retroactive effect, and is equivalent to a prior command." But the liability of the corporation, under such circumstances, does not rest upon any principle of the law of agency, but upon the immediate and voluntary act of the company. Although the acts of a corporation with reference to the

contracts made by promoters in its behalf before its organization are frequently loosely termed "ratification," yet "a ratification properly so called, implies an existing person, on whose behalf the contract might have been made at the time. There cannot, in law, be a ratification of a contract which could not have been made binding on the ratifier at the time it was made, because the ratifier was not then in existence. In *re* Empress Engineering Co., 16 Ch. Div. 128; *Melhado v. Porto Alegre, N. H. & B. Railway Co.*, L. R., 9 C. P. 505; *Kellner v. Baxter*, L. R., 2 C. P. 185. What is called "adoption," in such cases, is, in legal effect, the making of a contract of the date of the adoption, and not as of some former date. The contract in this case was, therefore, not within the statute of frauds. The trial court fairly submitted to the jury all the issues of fact in this case, accompanied by instructions as to the law which were exactly in the line of the views we have expressed; and the evidence justified the verdict.

The point is made that the plaintiff should have alleged that the contract was made with Nimocks, and subsequently adopted by the defendant. If we are correct in what we have said as to the legal effect of the adoption by the corporation of a contract made by a promoter in its behalf before its organization, the plaintiff properly pleaded the contract as having been made with the defendant. But we do not find that the evidence was objected to on the ground of a variance between it and the complaint. The assignments of error are very numerous, but what has been already said covers all that are entitled to any special notice. Order affirmed.

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PITTSBURG MINING CO. V. SPOONER.

SUPREME COURT OF WISCONSIN, 1889.

(74 Wis. 307.)

*Promoters.*

This action was brought by the Pittsburgh Mining Company for the purpose of recovering \$70,000 of money had and received by the defendants for the use of the company. The material allegations in the complaint are:

(1) That in February, 1887, the defendants conceived the idea and agreed together to promote the organization of the plain-

tiff corporation for the ostensible purpose of carrying on the business of mining iron on the Gogebic range, so called, in the state of Michigan, but for the real purpose of cheating those who might deal with said corporation, and by so doing enrich themselves.

(2) That in pursuance of such scheme the defendants obtained for the purpose of purchase or temporary control a mining option on said range, conferring the right to prospect, explore, and mine for iron on a tract of land described in the complaint. This option was owned by certain parties named in the complaint, and the price demand by them for it was \$20,000, and no more.

(3) That, having obtained the control of such option for the purposes of the corporation, the defendants proceeded to obtain subscriptions to the capital stock of the proposed corporation, to raise the money to buy it; that to induce subscriptions to said capital stock the defendants falsely and fraudently represented to divers persons, and to all persons who became and now are stockholders in said corporation, that the price demanded by the owners of said option was \$90,000, and that it could not be bought for less; that the defendants were themselves desirous of buying it, but were unable pecuniarily to pay so much money, but desired to organize a corporation to purchase it; that they would themselves become stockholders in the corporation to the extent of their ability to pay for the same; that there was no speculation in the purchase price; that the defendants were making nothing out of it,—not even their expenses, unless the corporation saw fit to reimburse them,—except what all stockholders would make alike through the operation of the proposed corporation in mining the ores covered by said option.

(4) The defendants also represented that for the purpose of the successful operation of the business of mining on said tract of land it would be necessary for the corporation to raise the sum of \$100,000 in money,—\$90,000 for the purpose of purchasing the option from the owners thereof, and \$10,000 to be put in the treasury of the company for the purpose of developing the mines.

(5) In furtherance of said fraudulent scheme the defendants drew up, and by said fraudulent representations procured to be signed, a subscription paper, of which the following is a copy: "The undersigned hereby agree with A. H. Main, of the city of Madison, Dane county, Wisconsin, the owner of a mining option upon, in, and to all of the north half of the south-west quarter of section number 11, town 47, range 45 east of the Michigan meridian, situate, lying, and being in the county of Ontonagon, state of Michigan, and with each other, that they will take of and from the said A. H. Main the number of shares of non-assessable

paid up stock in the Pittsburg Mining Company, proposed to be formed, set opposite their respective names, and pay for the same the sum of \$2.50 per share; said payment to be made as soon as the company is duly incorporated, under and by virtue of either the laws of the state of Michigan or Wisconsin; and the said A. H. Main shall assign and transfer over to said corporation, and give and convey to said corporation, a perfect title to the same said option. It is understood that the capital stock of said corporation shall be \$1,000,000, in 40,000 shares, of \$25.00 each. It is also understood and agreed that a shaft has been sunk upon the land covered by said option, to a depth of about seventy feet, and that there is in sight, at such depth below the surface of the land so covered by said option, ten thousand tons of iron ore."

(6) The complaint then alleges that this subscription paper was signed by a large number of persons, agreeing to take shares in a sufficient amount in the whole to cover the entire proposed stock of the projected corporation, to-wit \$1,000,000.

(7) Immediately after said stock had been all subscribed, and on the 21st day of March, 1887, the defendants organized a corporation in conformity to the laws of this state, under the name of the "Pittsburg Mining Company," now the plaintiff in this action. The defendants were the only original incorporators; and on the 22d day of March, 1887, the first meeting of said corporation was held at Madison, in this state. All the defendants were present at such meeting. The defendant Spooner was elected president, and the defendant Main treasurer. That about the time of said meeting, and in furtherance of said fraudulent scheme, the defendant Main, with the advice and procurement of the other defendants, Spooner and Oakley, but in the joint interest of all of them, subscribed for the entire stock of said corporation, viz., \$1,000,000, except one share each of \$25, which were taken by the defendants Spooner and Oakley; and thereupon at the same meeting, by the unanimous vote of the defendants as sole corporators and directors, the following resolution was adopted, viz.: "*Resolved*, that in accordance with the subscription of A. H. Main to the capital stock of said company, the president and secretary hereof issue to him, or to such person or persons as he may direct, and in such number of shares as he may direct, all of the said stock, except two shares thereof, one of which is held by said Phillip L. Spooner, Jr., and the other by said F. W. Oakley; the said stock to the said Main to be issued as paid up in full, in consideration of his making and delivering to the president of the said corporation, for the said corporation, an assignment in writing, duly executed, of an option

which he now owns on the north half of the south-west quarter of section eleven, (11,) township forty-seven, (47,) range forty-five (45) west, Ontonagon county, Michigan."

(8) It is further alleged in the complaint that none of the stock subscribed for by said Main was ever issued to him, except the sum of \$25,000 now held by defendant Main. That although he conveyed to the corporation the mining option before mentioned in nominal payment for all of the stock of said corporation, neither the defendant Main nor any of the defendants ever had or held any valuable interest in said option above the price of \$20,000, which had to be paid to the owners thereof. That, said option having been procured and being held by the defendants, or by the defendant Main for them, as promoters and trustees of said corporation, whatever value or interest they possessed or could possess therein inured to and was the property of said corporation, when formed, without advance in price or other conditions; and it is further alleged that \$20,000 was the full value of said option.

(9) The complaint further alleges that the defendants, in furtherance of their fraudulent scheme, after said subscriptions were obtained, caused said option to be conveyed to said Main without any consideration; then caused the corporation to buy it from him for substantially its entire capital stock, caused the agreement to take shares in the projected company, as hereinbefore set forth, to read as an agreement to take them of said Main and pay him for them, instead of the company, and then issue the shares so subscribed for to the several persons who, by the agreement aforesaid, had agreed to take them; and collected from them the sum of \$100,000, paid the owners of the option \$20,000 for the same, kept \$10,000 in the treasury of the company, and fraudulently converted the remaining \$70,000 to their own use, in violation of their duty to the company, as its promoters, trustees, and directors; whereby the plaintiff has sustained a loss of \$70,000.

(10) The complaint further alleges that in procuring control of the said mining option, in organizing the corporation, securing subscriptions to the capital stock, collecting moneys thereon, paying for said option to the owners thereof, having it conveyed to the defendant Main, and by him to the plaintiff corporation, and in all other matters touching the organization of the plaintiff corporation, and the purchase of said option, the defendants became and were the promoters, agents and trustees of the plaintiff, and, while so acting, they could not, in law, by any pretext, pretense, or contrivance gain any personal profit or advantage over the plaintiff, or make any valid contract with it to its prejudice, and to further their individual advantage.

(11) It is further alleged in the complaint that the amount paid to the owners of said option by the defendants in behalf of the plaintiff was the sum of \$20,000; that the amount obtained by the defendants from the corporation on the fraudulent pretext that such payment was \$90,000, \$70,000 of which the defendants have diverted from the company, and fraudulently appropriated to their own use, and for this amount they are jointly indebted to the plaintiff as for so much money had and received to its use, and the plaintiff demands judgment for the said sum of \$70,000, with interest and costs.

To this complaint the defendants demurred, and allege as grounds of demurrer: (1) That the plaintiff has not legal capacity to sue; (2) that the complaint does not state facts sufficient to constitute a cause of action. Upon the argument of the demurrer in the circuit court, the court sustained the demurrer, and from the order sustaining the demurrer, the plaintiff appealed to this court.

Taylor J. Upon the hearing of the appeal in this court, no contention was made by the learned counsel for the respondents that the demurrer was properly sustained upon the first alleged ground, viz., that "the plaintiff has not legal capacity to sue." The only question argued at length was whether the complaint stated facts sufficient to constitute a cause of action. The learned counsel for the appellant corporation contends that the complaint states facts constituting a cause of action—*First*, upon the ground of actual fraud committed by the defendants upon the company by the sale of the mining option to the company for a sum greatly in excess of its real value, brought about by false representations as to its actual cost; and, *second*, that it states a cause of action against the defendants as the promoters of the corporation, and, as such, holding a relation of trust and confidence towards it; and that, acting as the agents and officers of the corporation, they sold to the corporation, and bought for the corporation, the mining option for the sum of \$70,000 more than its actual value and more than they paid for the same; that this was done without the knowledge and consent of the real stockholders of the corporation, and in fraud of their rights, and upon that ground they are liable to the corporation for the profits made by them on such sale to the corporation. The last alleged cause of action is the one upon which the learned counsel for the appellant mainly relies in this court, and is the one in favor of which the main argument of the learned counsel for the appellant is made.

Considering the defendants as the officers and promoters of the corporation at the time of the alleged purchase and sale complained of, it seems to me very clear that—laying out of view the

fact that the money of the stockholders paid for their stock to the corporation, and which money was paid to defendants for the mining option, was obtained by the issuing of full-paid shares to the stockholders upon the payment of 10 per cent. of their par value, in violation of the statute—there can hardly be room for a contention that, upon the facts stated in the complaint, a cause of action is not stated against the defendants. Under the allegations of the complaint we must treat the alleged sale of the mining option to the defendant Main for the entire stock of the corporation, viz., \$1,000,000, as a mere subterfuge and device to cover up the real transaction, which is substantially as follows: The defendants having obtained a right to purchase the mining option mentioned in the complaint for \$20,000, proceeded to form a corporation to make such purchase, representing to the persons who subscribed for the stock that it would cost \$90,000 to make such purchase, and, having first induced other persons to subscribe for the stock upon such representations, and to pay to the corporation upon or for their stock \$100,000, the corporation then, through its officers, the defendants themselves, purchased the option for \$90,000, paying the \$20,000 which it cost them with the money received by the corporation, and converting the \$70,000 to their own use. This is the substance of what is alleged to have been done by the company, and it appears to me to be immaterial as to the manner of doing it. It being shown that the defendants formed the company for the purpose of purchasing this option, and having induced the present stockholders to furnish \$90,000 of their money to make the purchase under the false impression created by the defendants that the defendants would be compelled to pay that amount for the purchase price, and the defendants having afterwards, as officers and agents of the company, purchased for the company such option, and paid themselves \$70,000 more than they knew they could purchase it for, and \$70,000 more than they in fact paid for the same, it seems to me there can be no doubt of their liability to refund to the corporation the \$70,000 so obtained. In making this statement we are not to be understood as making any charge of fraud or unfair dealing on the part of the very respectable citizens who are the defendants in this action; all that is intended is that, admitting that the allegations of the complaint in this action are true, then the result indicated follows. The truth or falsity of these statements is not now under consideration. For the purposes of this case, the defendants do not controvert them.

That the defendants were promoters of the corporation, and as such, and as the officers of the same, they assumed the position of agents and trustees of the corporation in the transaction

of its business, admitting the facts to be as stated in the complaint to be true, there can be no doubt. This is well established by the following cases cited by the learned counsel for the appellant, viz.: *Society v. Abbott*, 2 Beav. 559; *New Sombrero Phosphate Co. v. Erlanger*, L. R., 5 Ch. Div. 73; and *Phosphate Sewage Co. v. Hartmont*, Id. 394; 1 Mor. Priv. Corp. § 291; *In re Paper Box Co.*, L. R., 17 Ch. Div. 471. See, also, the case of *Railroad Co. v. Tiernan*, cited by the learned counsel for the respondents, 37 Kan. 606. Assuming that these defendants were the promoters of this corporation, and it being alleged in the complaint that two of them were the officers of the corporation when the sale and purchase were made, they must be treated as the agents and trustees of the corporation, and as such their duties and obligations towards it are clearly defined by the authorities above cited. The learned judge, in deciding the case, of *Railroad Co. v. Tiernan*, cites the rule of law governing their action, as laid down by the supreme court of Massachusetts in the cases of *Parker v. Nickerson*, 137 Mass. 487, and *Parker v. Nickerson*, 112 Mass. 195. In these cases the rule is stated as follows: "A trustee or agent cannot purchase on his own account what he sells on account of another, nor purchase on account of another what he sells on his own account; \* \* \* and, if he does so, the *cestui que trust* or principal, unless upon the fullest knowledge of all the facts he elects to confirm the act of the trustee or agent, may repudiate it, or he may charge the profits made by the trustee or agent with an implied trust for his benefit." See *Tyrrell v. Bank*, 10 H. L. Cas. 26; *Kimber v. Barber*, L. R., 8 Ch. 56; *Simons v. Vulcan etc. Mining Co.*, 61 Pa. St. 202. This rule has been sanctioned and affirmed by this court. See *Puzey v. Senier*, 9 Wis. 370; *Pickett v. School-Dist.*, 25 Wis. 551; *Cook v. Mill Co.*, 43 Wis. 433; *In re Orphan Asylum*, 36 Wis. 534. Construed as I think the allegations in this case ought to be construed upon a demurrer, they present the case of trustees and agents of the corporation selling property to the corporation on the one hand, and on the other hand buying for the corporation, and making a profit for themselves by the transaction of \$70,000. Under the rule of law above stated the corporation may charge such profits made by the trustees and agents with an implied trust for the benefit of the corporation, and may recover such money in an action brought by the corporation.

It is urged against this claim that at the time of the sale and purchase there were no persons interested in the corporation except the said agents and trustees themselves, and so no one was injured, as all parties then interested were fully aware of all the facts. We do not think this a true statement of the case. According to the allegations of the complaint, all the present



owners of the stock were interested parties. They were in fact the corporation, and the defendants represented them in making the sale, and not merely themselves. The relations which the defendants bore to the corporation in this case, according to the facts alleged in the complaint, are well stated by Chief Justice THOMPSON in the case of *Simons v. Vulcan etc. Mining Co.*, *supra*. After stating that it was claimed that the organized board of directors was the company, and whatever it did could not be inquired into by the corporation put in motion by the instance of the stockholders, he says: "This is an error, and results from overlooking the fact that directors are but the agents and trustees of the company; that they have power to act only for the interest of the company, and not against it. The shareholders constitute the company, where there is stock, and not the directors. It was therefore well put in the charge of the learned judge that the directors had no power to bind the stockholders by allowing profits to the defendants, after holding out in their prospectus that the property was obtained at original prices, and that the defendants could not claim any if they hold out that they had purchased the property for the company, and were conveying at original prices. A fraud perpetrated against the corporation by any or all of the directors may assuredly be redressed by such an action in the name of the corporation. As already said, they are its agents and trustees, which implies accountability to their principal." In the case *In re Paper Box Co.*, L. R., 17 Ch. Div. 471, the Master of the Rolls says: "I quite agree to this: that, if promoters make an arrangement to get a profit for themselves out of what is apparently paid to the vendors, it is immaterial whether the contract with the vendors is approved of by the directors of the company, who are the promoters, just before the allotment or just after. In both cases it is intended to cheat the future shareholders, and of course it makes no difference whatever that the persons who at the time the allotment was made were in fact the promoters or their nominees, knew of the fraud." It seems to me, unless we are prepared to go contrary to the cases above cited, and to very many others cited in the brief of the appellant, we must hold that an action can be maintained in the name of the corporation to redress the wrong alleged to have been done by the defendants.

What would have been the relations of the defendants to the corporation if they had in fact owned the mining option, and had formed the corporation and issued full-paid stock to themselves for such option, and transferred such stock to themselves in payment for such mining option, and then, by exaggerated or false statements as to the value for such mining option, or as to its actual cost, had induced others to purchase from them such stock,

need not be determined in this action; nor whether in such case any action for such fraud could be maintained by the corporation. Under the allegations of the complaint, such was not the transaction in this case. In this case no sale to or purchase by the corporation was made until all the stock, or nearly all, had been agreed to be taken by other parties than the defendants, and, although the written agreement with they signed stated that they were to buy the stock of defendants, the allegations of the complaint show that at the time such contract was signed by the present stockholders the defendants did not have or own any of the stock of the corporation, nor did they own the mining option. The allegations also show that no stock was ever issued to the defendants except to the amount of \$25,000, and the balance of the stock was issued by the corporation directly to the present holders; and the mining option was bought by the defendants and sold to the company after such stock had been subscribed and paid for by the present stockholders, with the money paid by the stockholders to the corporation. What is said by the learned author (1 Mor. Priv. Corp. § 292, p. 279) in commenting upon the case of the Sombrero Phosphate Co., L.R., 5 Ch. Div. 73, is peculiarly applicable to the case at bar. In discussing the question whether the action would lie in favor of the corporation he says: "Before any shares had been issued the existence of the company was a fiction. The shareholders really formed the company, each one becoming a member when he took his shares. While the contract for the purchase of the property was nominally in force from the time of its approval by the board of directors, yet it really took effect only after the shareholders had taken their shares. It then became binding upon all the shareholders collectively, or, in other words, on the company. The fraud really consisted in inducing the shareholders to enter into this contract in their collective capacity, and in using the funds belonging to the shareholders collectively in paying the purchase price. It is evident, therefore, that the injury to the shareholders was an injury to their collective or corporate interests, and that the company was the proper complainant." These remarks are strictly applicable to the transaction in this case. It is true that it is alleged that the defendants formed a corporation under the statutes of this state, and that such corporation passed a resolution to permit the defendant Main to subscribe for the whole capital stock, and pay for it by a transfer of the mining option to the corporation; but it appears from the complaint that before this was done an agreement had been made between the defendants and the corporation that other persons should become the owners of the stock of the corporation, and pay a certain sum of money for such stock, and thereby become the real parties constituting the corporation,

and that their money should pay for the mining option; and it further appears that the transfer was not made to the corporation until after the real stockholders had become such by paying their money for the stock. The fraud in the sale was therefore a fraud upon the collective interests of the shareholders, as it was in the Sombrero Phosphate Co. Case.

Taking all the allegations of the complaint together, they charge the defendants with purchasing the mining option for the sum of \$20,000 from themselves for the benefit of the corporation, the corporation at the time of the sale and purchase representing the present holders of its stock, and not simply the interest of themselves. That this complaint states a good cause of action in favor of the corporation against the defendants, we think, is well settled upon principles and authority. The cases above cited of New Sombrero Phosphate Co. v. Erlanger, L. R., 5 Ch. Div. 73, Phosphate Sewage Co. v. Hartmont, L. R., 5 Ch. Div. 394, and Simons v. Vulcan etc. Mining Co., 61 Pa. St. 202, as well as many of the other cases cited in the brief of the counsel for the appellant, very clearly sustain this action.

It is, however, urged in a very able argument by the counsel for the defendants that, admitting the corporation would have a cause of action against the defendants for the profits made by them on the sale of the mining option to the corporation, had the corporation obtained the money with which it paid the defendants for such option in a lawful way, still, as the allegations of the complaint show that it obtained such money by an illegal issue or sale of its stock to its corporators, no action will lie to recover of the defendants any part of the money so illegally obtained by the corporation. Under my construction of the allegations of the complaint, it is very clear that the fact that the corporation received the money which paid the defendants for their mining option upon an illegal issue of its stock cannot be a defense to this action to compel them to refund to the company so much of the purchase price as was unlawfully received by them on such sale. The basis of the argument of the learned counsel is that these defendants received the money of the stockholders upon this alleged illegal sale of the stock as the agents of the corporation, and that as such agents they cannot be made to account to their principal for the money so received by them upon such illegal sales. Admitting this to be a true statement of the facts alleged in the complaint, I think, under the decisions of this and many other courts, these agents cannot set up the illegality of the transactions as a defense to an action by the principal to recover the money of its agents. I think, however, that the allegations of the complaint show that the money received on the sale of the

stock was in the possession of the corporation, and not merely in the possession of its agents, and, being so in the possession of the corporation, the defendants and agents of the corporation paid it over to themselves as the consideration for their mining option. Under the allegations of the complaint, they are not refusing to account for money collected by them as agents of the corporation in making sales of its stock, but they are refusing to account for money wrongfully obtained from the corporation upon a sale of their mining option to the company. Having changed their position in regard to this money by receiving it from the corporation as payment for the mining option sold to the company, they cannot now claim to hold it as money received by them as the agents of the corporation in making illegal sales of the stock of the corporation. The money paid to the corporation on such an illegal issue or sale of stock was, notwithstanding such illegal sale, the money of the corporation, as against all the world. The purchasers of such illegally issued stock could not recover back the money paid by them to the corporation upon such illegal transaction, (see *Clark v. Lincoln Lumber Co.*, 59 Wis. 655, 661, 665, 18 N. W. Rep. 492;) and, if they cannot recover it back from the corporation, no one else can. The corporation, having the possession of the money, is for all practical purposes the owner of it; and, if these defendants took the money from the corporation in an illegal and fraudulent way, it is no defense to such illegal act that the corporation obtained the money by a violation of the statute in selling its stock. If A. obtains the title and possession of property from B. by some fraudulent device, and C. obtains the same property of A. by fraud, and A. brings an action against C. to recover the property back, or for damages for the fraud it would be no defense for C. that A. had fraudulently obtained it from B. This would certainly be so, unless B. made a claim for the property against C. In this case the persons whose money came to the possession of the corporation cannot enforce any claim to it as against the corporation, and consequently they could not enforce a claim to it is against the persons to whom the corporation transferred it, and, if the present stockholders were instrumental in bringing this action in the name of the corporation, as they must be held to be, by bringing it in the name of the corporation, they affirm the right of the corporation to the money so received by it. By what rule of law have the defendants the right to challenge the title of the corporation to the money which was paid to them upon the sale of their mining option to the corporation? I am unable to perceive any such right, especially in a case of this kind, where no other person can claim the money.

If it should be urged that the allegations of the complaint show that there are no legal stockholders, and no legal stock issued, and so no corporation which can maintain this action, it is answered by saying that the defendants are in no position to attack either the issue of the stock or the illegality of the organization of the corporation. These defendants, who were the active agents in the formation of the corporation, who were instrumental in the issue of the alleged illegal stock, and who contracted with the corporation having full knowledge of all of its transactions, are in no position to contest the regularity of the formation of the corporation. 2 Mor. Priv. Corp. §§ 750-754, and the numerous cases cited in the notes; Chubb v. Upton, 95 U. S. 665-667; Cowell v. Springs Co., 100 U. S. 55, 60; People v. La Rue, 67 Cal. 526, 8 Pac. Rep. 84. In my view of the case, these defendants, as agents and trustees of the corporation, sold their mining option to the corporation, and received from the corporation \$70,000 in money of the corporation more than in law and equity they were entitled to receive therefor; and in law and equity they hold this money in trust for the corporation from which they received it. That the defendants, after having obtained from the corporation its money, which, in accordance with the principles of equity, they have no right to retain, may now refuse to refund on the allegation that the corporation was not in all respects organized in accordance with law, seems to me a proposition wholly unsupported by authority, and contrary to justice and equity. Under a proper construction of the allegations of the complaint, the illegal issue of the stock by the corporation, and the receipt of the money for such stock, was a completed transaction before the acts upon which the corporation rely for a recovery against the defendants transpired; and so the illegal act is in no way the foundation of the action. Briefly, the foundation of the claim of the plaintiff is this: The corporation having in its possession \$90,000, the defendants, as agents and trustees of the corporation, sold their mining claim to the corporation for \$90,000, and, acting for the corporation, they bought it for the corporation, and paid out its money to complete the purchase; and that, in making such sale and purchase, they so conducted themselves that they were and are not entitled, as against the corporation, to retain the profits made on the sale, but hold such profits in trust for the corporation. Under such circumstances, it appears to me wholly immaterial how the corporation became possessed of the money received by the defendants, unless they can show that some other person or party has a better claim to such money than the corporation.

I have not discussed the question as to the right of the corporation to recover the money on the theory that they collected

the same as the agents of the corporation, for the benefit of the corporation, and now hold it as such agent, because it seems to me that a fair construction of the allegations of the complaint do not show that such is the position of the defendants. If, under the allegations of the complaint, these defendants ever held this money as the agents of the corporation, they abandoned that position when they received it from the corporation as the purchase price of their mining option; and if they are entitled to hold the money at all they must hold it as vendors of such option, and as the purchase money thereof; and if they cannot, according to the rules of law and equity, hold it as such purchase money, then they must return it to the corporation. They cannot now assume to hold it as the agents of the corporation. In receiving the money as the purchase price of their option, they abandoned their position as agents of the corporation, if they ever were such as to this money, and cannot now assume such agency to defeat a recovery. *Fox v. Cash*, 11 Pa. St. 207; 2 *Benj. Sales*, 681. We think the complaint states a good cause of action in favor of the plaintiff, and that the circuit court erred in sustaining the demurrer to the complaint. The order of the circuit court is reversed, and the cause is remanded for further proceedings according to law.

Lyon, J., dissents.

## CHAPTER XVI.

## LIABILITY OF CORPORATION FOR TORTS.

## LAKE SHORE ETC., RAILWAY CO. V. PRENTICE.

SUPREME COURT OF THE UNITED STATES, 1893.

(147 U. S. 101.)

*Liability of a Corporation for a Malicious Tort—Punitive Damages.*

This was an action of trespass on the case against the defendant corporation to recover damages for the wrongful acts of the defendant's servants. On Oct. 12, 1886, the plaintiff, his wife and a number of other persons were passengers holding excursion tickets, on one of defendant's trains. During the journey the defendant purchased of several passengers their return tickets, which had nothing on them to show that they were not transferable. The conductor of the train learning this, and knowing that the plaintiff had been guilty of no offense for which he was liable to arrest, telegraphed for a police officer, an employee of the defendant, who boarded the train as it approached Chicago. The conductor thereupon, in a loud and angry voice, pointed out the plaintiff to the officer, and ordered his arrest; and the officer by directions of the conductor and without any warrant or authority of law, seized the plaintiff and rudely searched him for weapons, in the presence of the other passengers, hurried him into another car, and there sat down by him as a watch, and refused to tell him the cause of his arrest, or to let him speak to his wife. While the plaintiff was being removed into the other car, the conductor, for the purpose of disgracing and humiliating him with his fellow passengers, openly declared that he was under arrest and sneeringly said to the plaintiff's wife "where's your doctor now?" On arrival at Chicago the conductor refused to let plaintiff assist his wife with her parcels in leaving the train or to give her the check for their trunk, and in the presence of the passengers and others, ordered him to be taken to the station house, and he was forcibly taken there, detained until the conductor arrived, and knowing that the plaintiff had been guilty of no offense, entered the charge of disorderly conduct against him, upon which he gave bail and was released. No one appeared

against him next day and he was discharged. The declaration alleged that all these acts were done by the defendant's agents in the line of their employment, and that the defendant was legally liable therefore; that the plaintiff had thereby been put to great expense, and greatly injured in mind, body, and reputation. At the trial it was admitted that the arrest was wrongful and that the plaintiff was entitled to recover actual damages therefor. The court instructed the jury that if the defendant acted oppressively, wantonly and illegally they might also give the plaintiff punitive damages. Plaintiff had a verdict and defendant sued out a writ of error.

Mr. Justice Gray:—The only exceptions taken to the instructions at the trial, which have been argued in this court, are to those on the subject of punitive damages.

The single question presented for our decision, therefore, is whether a railroad corporation can be charged with punitive or exemplary damages for the illegal, wanton and oppressive conduct of a conductor of one of its trains towards a passenger.

This question like others affecting the liability of a railroad corporation as a common carrier of goods or passengers, such as its right to contract for exemption from responsibility for its own negligence, or its liability beyond its own line, or its liability to one of its servants for the act of another person in its employment, is a question, not of local law, but of general jurisprudence, upon which this court, in the absence of express statute regulating the subject, will exercise in its own judgement, uncontrolled by the decisions of the courts in the several States. *Railroad Co. v. Lockwood*, 17 Wall. 357, 368; *Liverpool Steam Co. v. Phenix Ins. Co.*, 129 U. S. 397, 443; *Myric v. Michigan Central Railroad*, 107 U. S. 102, 109; *Hough v. Railway Co.*, 100 U. S. 213, 226.

The most distinct suggestion of the doctrine of exemplary or punitive damages in England before the American Revolution is to be found in the remarks of Chief Justice Pratt, (afterwards Lord Camden) in one of the actions against the King's messengers for trespass and imprisonment under general warrants of the Secretary of State, in which, the plaintiff's counsel having asserted, and the defendant's counsel having denied, the right to recover, "exemplary damages," the Chief Justice instructed the jury as follows: "I have formerly delivered it as my opinion on another occasion, and I still continue of the same mind, that a jury have it in their power to give damages for more than the injury received. Damages are designed not only as a satisfaction to the injured person, but likewise as a punishment to the guilty, to deter from any such proceeding for the future, and as a proof of the detestation of the jury to the action itself." *Wilkes v. Wood*, Lofft, 1, 18, 19; S. C., 19 Howell's State Trials, 1153,



1167. See also, *Huckley v. Money*, 2 Wilson, 205, 207; S. C., *Sayer on Damages*, 218, 221. The recovery of damages, beyond compensation for the injury received, by way of punishing the guilty, and as an example to deter others from offending in like manner, is here clearly recognized.

In this court, the doctrine is well settled, that in actions of tort the jury, in addition to the sum awarded by way of compensation for the plaintiff's injury, may award exemplary, or punitive or vindictive damages, sometimes called smart money, if the defendant has acted wantonly, or oppressively, or with such malice as implies a spirit of mischief, or criminal indifference to civil obligations. But such guilty intention on the part of the defendant is required in order to charge him with exemplary or punitive damages. *The Amiable Nancy*, 3 Wheat, 546, 558, 559; *Day v. Woodworth*, 13 How. 363, 371; *Philadelphia & C. Railroad v. Quigley*, 21 How. 202, 213, 214; *Milwaukee & St. Paul Railway v. Arms*, 91 U. S. 489, 493, 495; *Missouri Pacific Railway v. Humes*, 115 U. S. 512, 521; *Barry v. Edmunds*, 116 U. S. 550, 562, 564; *Denver & Rio Grande Railway v. Harris*, 122 U. S. 597, 609, 610; *Minneapolis & St. Louis Railway v. Beckwith*, 129 U. S. 26, 36.

Exemplary or punitive damages, being awarded, not by way of compensation to the sufferer, but by way of punishment of the offender, and as a warning to others, can only award against one who has participated in the offence. A principal therefore, though of course liable to make compensation for injuries done by his agent within the scope of his employment, can not be held liable for exemplary or punitive damages, merely by reason of wanton, oppressive or malicious intent on the part of the agent. This is clearly shown by the judgment of this court in the case of *The Amiable Nancy*, 3 Wheat. 546.

In that case, upon a libel in admiralty by the owner, master, supercargo and crew of a neutral vessel against the owners of an American privateer, for illegally and wantonly seizing and plundering the neutral vessel and maltreating her officers and crew, Mr. Justice Story, speaking for the court, in 1818, laid down the general rules as to the liability for exemplary or vindictive damages, by way of punishment, as follows:—"Upon the fact disclosed in the evidence this must be pronounced a case of gross and wanton outrage, without any just provocation or excuse. Under such circumstances, the honor of the country and the duty of the court equally required that a just compensation should be made to the un-offending neutrals, for all the injuries and losses actually sustained by them. And if this were a suit against the original wrong doers, it might be proper to go yet farther, and visit upon them, in the shape of exemplary damages,

the proper punishment which belongs to such lawless misconduct. But it is to be considered that this is a suit against the owners of a privateer, upon whom the law has, from motives of policy devolved a responsibility for the conduct of the officers and crew employed by them, and yet, from the nature of the service, they can scarcely ever be able to secure to themselves an adequate indemnity in cases of loss. They are innocent of the demerit of this transaction, having neither directed it, nor countenanced it, nor participated in it in the slightest degree. Under such circumstances, we are of the opinion, that they are bound to repair all the real injuries and personal wrongs sustained by the libellants, but they are not bound to the extent of vindictive damages." 3 Wheat. 558, 559.

The rule thus laid down is not peculiar to courts of admiralty; for, as stated by the same eminent judge two years later those courts proceed, in cases of tort, upon the same principles as courts of common law, in allowing exemplary damages, as well as damages by way of compensation or remuneration for expenses incurred, or injuries or losses sustained, by the misconduct of the other party. *Boston Manuf. Co. v. Fisk*, 2 Mason, 119, 121. In *Keene v. Lizardi*, 8 Louisiana, 26, 33, Judge Martin said: "It is true, juries sometimes very properly give what is called smart money. They are often warranted in given vindictive damages as a punishment inflicted for outrageous conduct. But this is only justifiable in an action against the wrongdoer, and not against persons who, on account of their relation to the offender, are only consequentially liable for his acts, as the principal is responsible for the act of his factor or agent." To the same effect are: *The State Rights*, Crabbe, 22, 47, 48; *The Golden Gate*, McAllister, 104; *Wardrobe v. California Stage Co.*, 7 California 118; *Boulard v. Calhoun*, 14 La. Ann. 445; *Detroit Post v. McArthur*, 16 Mich. 447; *Grund v. Van Vleck*, 69 Illinois, 478, 481; *Becker v. Dupree*, 75 Ill. 167; *Rosencrauz v. Burkey*, 115 Ill. 331; *Kirksey v. Jones*, 7 Ala. 622, 629; *Pollock v. Gantt*, 69 Alabama, 373, 379; *Eviston v. Cramer*, 57 Wisconsin, 570; *Haines v. Schultz*, 21 Vroom, (50 N. J. Law) 481; *McCarthy v. De Armit*, 99 Penn. St. 63, 72; *Clark v. Newsam*, 1 Exch. 131, 140; *Clissold v. Machell*, 26 Upper Canada, Q. B., 422.

The rule has the same application to corporations as to individuals. This court has often, in cases of this class, as well as in other cases affirmed the doctrine that for acts done by the agents of a corporation, in the course of its business and of their employment, the corporation is responsible, in the same manner and to the same extent as an individual is responsible under similar circumstances. *Philadelphia &c. Railroad v. Quigley*, 21 How. 202, 210; *National Bank v. Graham*, 100 U. S. 699, 702; *Salt*

*Lake City v. Hollister*, 118 U. S. 256, 261; *Denver & Rio Grande Railway v. Harris*, 122 U. S. 597, 608.

A corporation is doubtless liable like an individual to make compensation for any tort committed by an agent in the course of his employment, although the act is done wantonly and recklessly, or against the express orders of the principal. *Philadelphia & Reading Railroad v. Derby*, 14 How. 468; *New Jersey Steamboat Co. v. Brockett*, 121 U. S. 637; *Howe v. Newmarch*, 12 Allen 49; *Ramsden v. Boston & Albany Railroad*, 104 Mass. 117. A corporation may even be held liable for a libel, or a malicious prosecution, by its agents within the scope of his employment; and the malice necessary to support either action, if proved in the agent, may be imputed to the corporation. *Philadelphia Railroad Co. v. Quigley*, 21 How. 202, 211; *Salt Lake City v. Hollister*, 118 U. S. 256, 262; *Reed v. Home Savings Bank*, 130 Mass. 443, 445 and cases cited; *Krulevitz v. Eastern Railroad*, 140 Mass. 573; *McDermott v. Evening Journal*, 14 Vroom, (43 N. J. Law) 488; and 15 Vroom (44 N. J. Law) 430; *Bank of New South Wales, v. Owston*, 4 App. Cas. 270. But, as well observed by Mr. Justice Field, now Chief Justice of Massachusetts: "The logical difficulty of imputing the actual malice or fraud of an agent to his principal is perhaps less when the principal is a person than when it is a corporation; still the foundation of the imputation is not that it is inferred that the principal actually participated in the malice or fraud, but, the act having been done for his benefit by his agent acting within the scope of his employment in his business, it is just that he should be held responsible for it in damages." *Lothrop v. Adams*, 133 Mass. 471, 480, 481.

Though the principal is liable to make compensation for a libel published or a malicious prosecution instituted by his agent, he is not liable to be punished by exemplary damages for an intent in which he did not participate. In *Detroit Post v. McArthur*, in *Eviston v. Cramer*, and in *Haines v. Schultz*, above cited, it was held that the publisher of a newspaper, when sued for a libel published therein by one of his reporters, without his knowledge, was liable for compensatory damages only, and not for punitive damages, unless he approved or ratified the publication; and in *Haines v. Schultz*, the Supreme Court of New Jersey said of punitive damages: "The right to award them rests primarily upon the single ground—wrongful motive." "It is the wrongful personal intention to injure that calls forth the penalty. To this wrongful intent knowledge is an essential prerequisite." "Absence of all proof bearing on the essential question, to-wit, defendant's motive cannot be permitted to take the place of evidence without leading to a most dangerous extension of the doctrine *respondeat*

superior." 21 Vroom (50 N.J. Law), 484, 485. Whether a principal can be criminally prosecuted for a libel published by his agent, without his participation, is a question on which the authorities are not agreed, and where it has been held that he can, it is admitted to be an anomaly in the criminal law. *Commonwealth v. Morgan*, 107 Mass. 199, 203; *Regina v. Holbrook*, 3 Q. B. D. 60, 62, 64, 70, and 4 Q. B. D. 42, 51, 60.

No doubt a corporation, like a natural person, may be held liable in exemplary or punitive damages for the act of an agent within the scope of his employment, provided the criminal intent necessary to warrant the imposition of such damages is brought home to the corporation. *Philadelphia, etc., Railroad Co. v. Quigley*, *Milwaukee & St. Paul Railway v. Arms*, and *Denver & Rio Grande Railway v. Harris*, above cited, *Caldwell v. New Jersey Steamboat Co.*, 47 N. Y. 282; *Bell v. Midland Railway*, 10 C. B. (N. S.) 287; S. c., 4 Law Times (N. S.) 293.

Independently of this, in the case of a corporation, as of an individual, if any wantonness or mischief on the part of the agent, acting within the scope of his employment, causes additional injury to the plaintiff in body or mind, the principal is, of course, liable to make compensation for the whole injury suffered. *Kennon v. Gilmer*, 131 U. S. 22; *Meagher v. Driscoll*, 99 Mass. 281, 285; *Smith v. Holcomb*, 99 Mass. 552; *Haws v. Knowles*, 114 Mass. 518; *Campbell v. Pullman Car Co.*, 42 Fed. Rep. 484.

In the case at bar, the defendant's counsel having admitted in open court "that the arrest of the plaintiff was wrongful, and that he was entitled to recover actual damages therefor," the jury were rightly instructed that he was entitled to a verdict which would fully compensate him for the injuries sustained, and that in compensating him the jury were authorized to go beyond his outlay in and about this suit and to consider the humiliation and outrage to which he had been subjected by arresting him publicly without warrant and without cause, and by the conduct of the conductor, such as his remark to the plaintiff's wife.

But the court, going beyond this, distinctly instructed the jury that "after agreeing upon the amount which will fully compensate the plaintiff for his outlay and injured feelings," they might "add something by way of punitive damages against the defendant, which is sometimes called smart money," if they were "satisfied that the conductor's conduct was illegal, wanton and oppressive."

The jury were thus told, in the plainest terms, that the corporation was responsible in punitive damages for wantonness and oppression on the part of the conductor, although not actually participated in by the corporation. This ruling appears to us to be inconsistent with the principles above stated, unsupported by any

decision of this court, and opposed to the preponderance of well considered precedents.

In *Philadelphia & Reading Railroad v. Derby*, which was an action by a passenger against a railroad corporation for a personal injury suffered through the negligence of its servants, the jury were instructed that "the damages, if any were recoverable, are to be confined to the direct and immediate consequences of the injury sustained," and no exception was taken to this instruction. 14 How. 470, 471.

In *Philadelphia etc., Railroad v. Quigley*, which was an action against a railroad corporation for a libel published by its agent, the jury returned a verdict for the plaintiff, under an instruction that "they are not restricted in giving damages to the actual positive injury sustained by the plaintiff, but may give such exemplary damages, if any, as in their opinion are called for and justified, in view of all the circumstances of this case, to render reparation to the plaintiff and act as an adequate punishment to the defendant." This court set aside the verdict because the instruction given to the jury did not accurately define the measure of the defendant's liability, and speaking by Mr. Justice Campbell, stated the rules applicable to the case in these words: "For acts done by the agents of the corporation, either *in contractu* or *in delicto*, in the course of its business and of their employment, the corporation is responsible, as an individual is responsible under similar circumstances. Whenever the injury complained of has been inflicted maliciously or wantonly, and with circumstances of contumely or indignity, the jury are not limited to the ascertainment of a simple compensation for the wrong committed against the aggrieved person. But the malice spoken of in this rule is not merely the doing of an unlawful or injurious act. The word implies that the act complained of was conceived in the spirit of mischief or criminal indifference to civil obligations. Nothing of this kind can be imputed to these defendants." 21 How. 210, 213, 214.

In *Milwaukee & St. Paul Railway v. Arms*, which was an action against a railroad corporation, by a passenger injured in a collision caused by the negligence of the servants of the corporation, the jury were instructed thus: "If you find that the accident was caused by the gross negligence of the defendant's servants controlling the train you may give to the plaintiff punitive or exemplary damages." This court, speaking by Mr. Justice Davis, and approving and applying the rule of exemplary damages, as stated in *Quigley's Case*, held that this was a misdirection, and that the failure of the employes to use the care that was required to avoid the accident, "whether called gross or ordinary negligence, did not authorize the jury to visit the company with damages be-

yond the limit of compensation for the injury actually inflicted. To do this, there must have been some wilful misconduct, or that entire want of care which would raise the presumption of a conscious indifference to consequences. Nothing of this kind can be imputed to the persons in charge of the train, and the court, therefore, misdirected the jury." 91 U. S. 495.

In *Denver & Rio Grande Railway v. Harris*, the railroad company, as the records showed, by an armed force of several hundred men, acting as its agents and employes, and organized and commanded by its vice-president and assistant general manager, attacked with deadly weapons the agents and employes of another company in possession of a railroad and forcibly drove them out, and in doing so fired upon and injured one of them, who thereupon brought an action against the corporation and recovered a verdict and judgment under an instruction that the jury "were not limited to compensatory damages, but could give punitive or exemplary damages, if it was found that the defendant acted with bad intent and in pursuance of an unlawful purpose to forcibly take possession of the railway occupied by the other company, and in so doing shot the plaintiff." This court, speaking by Mr. Justice Harlan, quoted and approved the rules laid down in *Quigley's Case*, and affirmed the judgment, not because any evil intent on the part of the agents of the defendant corporation could of itself make the corporation responsible for exemplary or punitive damages, but upon the single ground that the evidence clearly showed that the corporation, by its governing officers, participated in and directed all that was planned and done. 122 U. S. 610.

The president and general manager, or in his absence, the vice-president in his place, actually wielding the whole executive power of the corporation, may well be treated as so far representing the corporation and identified with it, that any wanton, malicious or oppressive intent of his in doing wrongful acts in behalf of the corporation, to the injury of others, may be treated as the intent of the corporation itself. But the conductor of a train, or other subordinate agent or servant of a railroad corporation, occupies a very different position, and is no more identified with his principal, so as to affect the latter with his own unlawful and criminal intent, than any agent or servant standing in a corresponding relation to natural persons carrying on a manufactory, a mine, or a house of trade or commerce.

The law applicable to this case has been found nowhere better stated than by Mr. Justice Brayton, afterwards Chief Justice of Rhode Island, in the earliest reported case of the kind, in which a passenger sued a railroad corporation for his wrongful expulsion from a train by the conductor and received a verdict, but excepted

to an instruction to the jury that "punitive or vindictive damages or smart money were not to be allowed as against the principal, unless the principal participated in the wrongful act of the agent, expressly or impliedly, by his conduct authorizing it or approving of it either before or after it was committed." This instruction was held to be right for the following reasons: "In cases where punitive or exemplary damages have been assessed it has been done upon the evidence of such wilfulness, recklessness or wickedness, on the part of the party at fault, as amounted to criminality, which for the good of society and warning to the individual ought to be punished. If in such cases or in any case of a civil nature it is the policy of the law to visit upon the offender such exemplary damages as will operate as punishment and teach the lesson of caution to prevent a repetition of criminality, yet we do not see how such damages can be allowed where the principal is prosecuted for the tortious act of his servant, unless there is proof in the cause to implicate the principal and make him *particeps criminis* of his agent's acts. No man should be punished for that of which he is not guilty. Where the proof does not implicate the principal, and however wicked the servant may have been, the principal, neither expressly nor impliedly, authorized or ratifies the act, and the criminality of it is as much against him as against any other member of society, we think it is quite enough that he should be liable in compensatory damages for the injuries sustained in consequence of the wrongful act of a person acting as his servant." *Hagan v. Providence & Worcester Railroad*, 3 Rhode Island, 88, 91.

The like view was expressed by the Court of Appeals of New York in an action brought against the railroad corporation by a passenger for injuries suffered by the neglect of a switchman, who was intoxicated at the time of the accident. It was held that evidence that the switchman was a man of intemperate habits, which was known to the agent of the company having the power to employ and discharge him and other subordinates, was competent to support a claim for exemplary damages, but that a direction to the jury in general terms that in awarding damages they might add to full compensation for the injury "such sum for exemplary damages as the case calls for, depending in a great measure of course upon the conduct of the defendant," entitled the defendant to a new trial, and Chief Justice Church, delivering the unanimous judgment of the court, stated the rule as follows: "For injuries by the negligence of a servant while engaged in the business of the master, within the scope of his employment, the latter is liable for compensatory damages; but for such negligence, however gross or culpable, he is not liable to be punished

in punitive damages, unless he is also chargeable with gross misconduct. Such misconduct may be established by showing that the act of the servant was authorized or ratified, or that the master employed or retained the servant, knowing that he was incompetent, or from bad habits, unfit for the position he occupied. Something more than ordinary negligence is requisite, it must be reckless and of a criminal nature, and clearly established. Corporations may incur this liability as well as private persons. If a railroad company, for instance, knowing and wantonly employs a drunken engineer or switchman, or retains one after knowledge of his habits is clearly brought home to the company or to a superintending agent authorized to employ or discharge him, and injury occurs by reason of such habits, the company may and ought to be amenable to the severest rule of damages; but I am not aware of any principle which permits a jury to award exemplary damages in a case which does not come up to this standard, or to graduate the amount of such damages by their views of the propriety of the conduct of the defendant, unless such conduct is of the character before specified." *Clegran v. New York Central Railroad*, 56 N. Y. 44, 47, 48.

Similar decisions, denying upon like grounds the liability of railroad companies and other corporations sought to be charged with punitive damages for the wanton or oppressive acts of their agents or servants, not participated in or ratified by the corporation, have been made by the courts of New Jersey, Pennsylvania, Delaware, Michigan, Wisconsin, California, Louisiana, Alabama, Texas and West Virginia.

It must be admitted that there is a wide divergence in the decisions of the state courts upon this question, and that corporations have been held liable for such damages under similar circumstances in New Hampshire, in Maine, and in many of the Western and Southern States. But of the three leading cases on that side of the question, *Hopkins v. Atlantic & St. Lawrence Railroad*, 36 N. H. 9, can hardly be reconciled with the later decisions in *Fay v. Parker*, 53 N. H. 342, and *Bixby v. Dunlap*, 56 N. H. 456, and in *Goddard v. Grand Trunk Railway*, 57 Maine, 202, 228, and *Atlantic & Great Western Railway v. Dunn*, 19 Ohio St. 162, 590, there were strong dissenting opinions. In many, if not most, of the other cases, either corporations were put upon different grounds in this respect from other principals, or else the distinction between imputing to the corporation such wrongful act and intent as would render it liable to make compensation to the person injured, and imputing to the corporation the intent necessary to be established in order to subject it to exemplary damages by way of punishment, was overlooked or disregarded.

Most of the cases on both sides of the question not specifically



cited above are collected in 1 Sedgwick on Damages (8th ed.), § 380.

In the case at bar the plaintiff does not appear to have contended at the trial, or to have introduced any evidence tending to show that the conductor was known to the defendant to be an unsuitable person in any respect, or that the defendant in any way participated in, approved or ratified his treatment of the plaintiff; nor did the instructions given to the jury require them to be satisfied of any such fact before awarding punitive damages. But the only fact which they were required to find, in order to support a claim for punitive damages against the corporation, was that the conductor's illegal conduct was wanton and oppressive. For this error, as we cannot know how much of the verdict was intended by the jury as a compensation for the plaintiff's injury, and how much by way of punishing the corporation for an intent in which it had no part, the judgment must be reversed and the case remanded to the Circuit Court, with directions to set aside the verdict and to order a new trial.

Mr. Justice Field, Mr. Justice Harlan and Mr. Justice Lamar took no part in this decision.

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## CHESTNUT HILL TURNPIKE COMPANY V. RUTTER.

SUPREME COURT OF PENNSYLVANIA, 1818.

(4 Serg. R. 6.)

### *Liability of a Corporation for a Tort.*

Action of trespass for stopping a water course.

Tilghman C. J.:— \* \* \* But it is objected that the present action is not on contract but on tort, and a very refined argument is brought forward, to prove that a corporation cannot be guilty of a tort. A corporation, say the defendant's counsel is a mere creature of law, and can act only as authorized by its charter. But the charter does not authorize it to do wrong, and therefore it can do no wrong. The argument is fallacious in its principles, and mischievous in its consequences, as it tends to introduce actual wrongs and ideal remedies; for a turnpike company may do great injury, by means of laborers who have no property to

answer the damages recovered against them. It is much more reasonable to say, that when a corporation is authorized by law to make a road, if any injury is done in the course of making that road by the persons employed under its authority, it shall be responsible, in the same manner that an individual is responsible for the actions of his servants, touching his business. The act of the agent is the act of the principal. There is no solid ground for a distinction between contracts and torts. Indeed, with respect to torts, the opinion of the courts seem to have been more uniform than with respect to contracts. For it may be shown, that from the earliest times to the present, corporations have been held liable for torts. Many cases have been cited from the Year Books. Upon examination, they do not all answer the citations, but enough appears to show that the law was so understood. In 4 Hen. 7, p. 13, pl. 11, we find an action of trespass against the Mayor and Commonalty of York. Plea, that all the inhabitants had a right of common in the land where the trespass is supposed to have been committed: held, not good, because the action is against the corporation, and the plea is a justification as to individuals. In a subsequent part of this case, it is said that a corporation cannot give a warrant to commit a trespass without writing. This, if it be law, proves that a warrant may be given by writing, which is sufficient for the plaintiff's purpose, the point being, whether a corporation can commit a trespass. In 8 Hen. 6, p. 1, pl. 11, and p. 14, pl. 34, trespass was brought against the Mayor and Bailiffs, and Commonalty of Ipswich, and one J. Jabez. It was objected, that a corporation and an individual cannot be joined in one action; but it was not objected that trespass does not lie against a corporation; and the objection is said to have been overruled in 14 Hen. 8, 2. In the book of Assizes (31 Ass. pl. 19), it appears that an assize of novel disseisin was maintained against the Mayor and Commonalty of Winton. Brook lays it down, that if the mayor and commonalty disseise one who releases to several individuals of the corporation, this will not serve the Mayor and Commonalty, because the disseisin is in their corporate capacity. In the old books of entries are numerous precedents of writs of *quare impedit* against corporations, and in Vidian's Ent. 1, is a declaration in an action on the case (16 Car. 2), against the Mayor and Commonalty of the city of Canterbury, for a false return to a mandamus. To come to more modern times, it was held in the *Mayor of Lynn, &c. (in error) v. Turner* (Cowp. 86), that an action on the case lies against a corporation for not cleansing and keeping in repair a stream of navigable water, which it was bound to do by prescription, in consequence of which the plaintiff was injured. This was in the year 1774, a little before our Revolution. The laws

of the Commonwealth forbid my tracing this point through the English courts, since the Revolution, but we shall find abundant authority in the courts of our own country. In *Gray v. The Portland Bank* (6 Mass. Rep. 364), it is laid down, that the bank was responsible for wrongs done by itself or its agents. In *Riddle v. The Proprietors of the Locks, etc. on Merrimack River* (7 Mass. Rep. 169), an action was maintained against the company for damage suffered by the plaintiff in consequence of the locks not being kept in repair. And in *Townsend v. The Susquehanna Turnpike Company* (6 Johns, 91), an action was supported for the loss of a horse killed by the falling of a bridge, which the company had built of bad materials. These authorities put it beyond doubt that the form of action, in the present case, is good.

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GOODSPEED V. BANK.

SUPREME COURT OF CONNECTICUT, 1853.

(22 Conn. 530.)

*Liability for Torts.—Malice.*

Church, C. J.: This action is based upon the provisions of our statute, entitled, "An act to prevent vexatious suits," and is subject to the same general principles as are actions on the case for malicious prosecutions, at common law.

The plaintiff alleges, that the defendants, the East Haddam Bank, a body politic and corporate, without probable cause, and with a malicious intent unjustly to vex, harass, embarrass, and trouble the plaintiff, commenced by a writ of attachment, and prosecuted against him, a certain vexatious suit or action for fraudulent representations, to the injury of said bank, and which action resulted in a verdict and judgment against the bank, and in favor of the present plaintiff.

On the trial of this cause, by the superior court, the defendants moved for a nonsuit, on the ground that the plaintiff by his evidence had failed to make out a *prima facie* case; which motion the court granted, and judgment of nonsuit was entered against the plaintiff, which he now moves to set aside.

The judgment of the superior court, in granting the nonsuit, as we understand, was founded solely upon the ground that a corporation aggregate was not, by law, liable for such a cause of action as was set up by the plaintiff, in his declaration,—at least,

no other ground of nonsuit or objection to the plaintiff's action has been argued before us. And, therefore, irrespective of the evidence detailed in the motion, we confine ourselves to what we suppose to be the sole question in the case.

We assume that the plaintiff has sustained the damage he claims, by reason of the prosecution of the vexatious suit, and the question is, has he a legal remedy against the bank?

The claim of the defendants is, that the remedy for this injury is to be sought against the directors of the bank, or the individuals, whoever they might have been, by whose agency the vexatious suit was prosecuted, and not against the corporation. We think, that, to turn the plaintiff round to pursue the proposed remedy, would be trifling with him and with his just rights, and would be equivalent to declaring him remediless; and, in this case, at least, that there was a wrong where there is no remedy. It is notorious that, ordinarily, the action of bank directors is private, — that their records do not disclose the names of the individuals supporting or opposing any resolution or vote, and if they do, that the offending persons may be irresponsible and insolvent. The language of Tilghman, C. J., in a case very similar to the present, in which it was urged that a corporation was not liable for a suit, but only the individuals committing it, is applicable here. "This doctrine," he said, "was fallacious in principle, and mischievous in its consequences, as it tends to introduce actual wrongs and ideal remedies; for a turnpike company might do great injury, by means of laborers having no property to answer damages," &c. (4 Serg. & Rawle, 16). To the same effect is the language of Shaw, C. J., in the case of *Thayer v. Bastan* (19 Pick. 511). He says, "The court are of opinion, that this argument, if pressed to all its consequences, and made the foundation of an inflexible practical rule, would often lead to very unjust results."

Still more explicit is the opinion of the court, in the case of *The Life and Fire Insurance Company v. Mechanics' Fire Insurance Company* (7 Wend. 31). There, as here, it was contended, that the act was unauthorized, and must therefore be considered as the act of the officers of the company, and not of the company itself. And the court says, "This would be a most convenient distinction for corporations to establish: that every violation of their charter or assumption of unauthorized power, on the part of their officers, although with the full knowledge and approbation of the directors, is to be considered the individual act of the officers, and is not to prejudice the corporation itself. There would be no possibility of ever convicting a corporation of exceeding its powers, and thereby forfeiting its charter, or incurring any other penalty, if this principle could be established."

The real nature, as well as the law, of corporations, within the last half century, has been in a progress of development, so that it has grown up, from a few rules and maxims, into a code. In the days of Blackstone, the whole subject of corporations, and the laws affecting them, were discussed within the compass of a few pages; now volumes are required for this purpose. These institutions have so multiplied and extended within a few years, that they are connected with, and in a great degree influence all the business transactions of this country, and give tone and character, to some extent, to society itself. We do not complain of this; but we say, that, as new relations from this cause are formed, and new interests created, legal principles of a practical rather than of a technical or theoretical character, must be applied.

And so, in the course of this progress, it has been. It was said by Lord Coke, "that corporations had neither souls nor bodies;" and by somebody else, "that they had no moral sense;" and from thence, or for some other equally insufficient reason, it was inferred, and so repeatedly adjudged, that they could not be subjected in actions of trover, trespass, or disseisin, and indeed, that they could not commit wrongs, nor be liable for torts, with a few exceptions, as we shall see.

Had Lord Coke lived in this age and country, he would have seen, that corporations, instead of being the soulless and unconscious beings he supposed, are the great motive powers of society, governing and regulating its chief business affairs; that they act, not only upon pecuniary concerns, but, as having conscience and motives, to an almost unlimited extent, they are entrusted with the benevolent and religious agencies of the day, and are constituted trustees and managers of large funds promotive of such objects.

The views of the old lawyers regarding the real nature, power, and responsibilities of corporations, to a great extent are exploded in modern times, and it is believed, that now these bodies are brought to the same civil liabilities as natural persons, so far as this can be done practically, and consistently with their respective charters. And no good reason is discovered why this should not be so; nor why it cannot be done, in a case like this, without violating any sensible or useful principle.

And although it was truly said, and for obvious reasons, that corporations could not be punished corporally, as traitors or felons, yet they may be, and have often been, subjected to fines and forfeitures, for malfeasance, and even to the loss of corporate life, by the revocation of their charters. And now it seems to be generally admitted, that they are civilly responsible, in their corporate capacities, for all torts which work injury to others,

whether acts of omission or commission; for negligence merely, and for direct violence. *Yarborough v. Bank of Eng.*, 16 East, 6; *Beach v. Fulton Bank*, 7 Cowen, 486; *Foster v. Essex Bank*, 17 Mass. 503; *Riddle v. Proprietors of Locks and Canals*, 7 id. 187; *Chestnut Hill Turnpike v. Rutter*, 4 Serg. & Rawle, 16; 4 Hammond, 500, 514; 10 Ohio Rep. 159; *Dater v. Truy Turnpike Co.*, 2 Hill, 630; 23 Pick. 139, 2 Bl. Com. 476; Ang. & Ames, 392; 2 Kent Com. 290; 1 Sw. Dig. 75; 15 Ohio Rep. 476; 18 id. 229. And indeed, no actions are now more frequent, in our courts, than such as are brought against corporations, for torts, either in case or trespass. *Harnerv. New Haven & Northampton Canal Co.*, 14 Conn. 146, and the cases there cited, and many others since reported. In a late case in England, it has been adjudged, adversely to former opinions, that an action of assault and battery may be sustained against a corporation. *Eastern Counties Railway Co. v. Brooks*, 2 Eng. Law & Equity, 406. And it was decided long ago, that a corporation was liable to an action for a false return to a writ of mandamus, alleged to have been made falsely and maliciously. 16 East, 8; 14 Eng. Com. Law, 159; 3 Mees. & Wels. 244; Ang. & Ames, ch. 10, sec. 9.

In all the cases, wherein it has been holden that corporations may be subjected to civil liabilities for torts, the acts charged as such have been the acts of their constituted authorities,—either the directors, or agents, or servants, employed by them. We do not intend here to discuss or decide the frequently suggested question, how far, or when a principal, whether an individual person or a corporation, becomes responsible for the wilful or malicious act of his servant or agent, as distinguished from his mere negligence, although it has been brought into the argument of this case, because we do not admit that the present case falls within the operation of the rule of law on this subject, even at the defendants claim it.

The truth is, the action complained of as vexatious was instituted by the bank, in the name of the bank, and, as should be presumed, in just the same way and by the same agencies and means, as all other suits by these institutions are commenced and prosecuted, and nothing appears here, showing any different procedure than is usual, in actions by corporations. The action was brought for the sole benefit of the bank, for the recovery of money to which the bank was entitled, if anybody, and for an injury sustained by the bank in its corporate capacity. The bank, by its charter and the general laws, had power to sue for such a cause of action; and what seems to us yet more conclusive, is, that if this suit was originated by the misconduct of directors, or any officer of the company, it has never been repudiated, and may,

by the acquiescence of the bank, be considered as sanctioned by it. Ang. & Ames, ch. 10, sec. 9. No act of agency appears here, which does not appear in all suits brought by corporations, and nothing to show that any individuals are, or ought to be, made responsible for the institution and prosecution of the groundless suit, as distinct from the corporation itself.

The doctrine, that principals are not responsible for the wilful misconduct of their agents, as seems to have been sanctioned in the cases of *McManus v. Cricket*, 1 East, 106; *Wright v. Wilcox* 19 Wend. 343; *Vanderbilt v. Richmond Turnpike Co.*, 2 Comstock, 470; but denied by Chief Justice Reeve in his *Domestic Relations*, 357, we think, has never been applied to such a case as this, but only to the acts of agents or servants, properly so called; or such as act under instructions and a delegated authority,—persons whose duty it is to obey, not to control; as attorneys, cashiers, or others employed by the corporation. The president and directors of a bank, instead of being mere servants, are really the controlling power of the corporation,—the representatives, standing and acting in the place of the interested parties. Indeed, they are the mind and soul of the body politic and corporate, and constitute its thinking and acting capacity. In the case of *Barrell v. The Nahant Bank*, 2 Met. 163, Shaw, C. J., expresses and defines the true rule of appreciating the character and powers of bank directors. He says, "We think the exception takes much too limited and strict a view of the powers of bank directors. A board of directors is a body recognized by law. By the laws of these corporations, and by the usage, so general and uniform as to be regarded as a part of the law of the land, they have the general superintendence and active management of all the concerns of the bank, and constitute, to all purposes of dealing with others, the corporation. We think they do not exercise a delegated authority in the sense to which the rule applies to agents and attorneys," &c. The same principle is very distinctly recognized, in the cases of *Bank Commissioners v. Bank of Buffalo*, 6 Paige's Ch. 502, and *Life and Fire Ins. Co. v. Mechanics' Fire Ins. Co.*, 7 Wend. 31. It has been said, that the stockholders constitute the corporation. It may be so, to the extent to which they have the power to act,—and this is only in the choice of directors, and no more. Beyond this, they can only be considered as the persons for whose ultimate individual interest the corporation acts. The directors derive all their power and authority from the charter and laws, and none from the stockholders.

But the fear is expressed, that, by thus considering and treating the character and acts of the directors of a bank or other corporation, the stockholders are subject to loss, without fault of

their own. This may to some extent be true; but the protection of the law in this matter is not to be confined to stockholders; the public and strangers have rights also. The stockholders are volunteers, and they have consented to assume the risk of the faithful or unfaithful management of the corporation. If, in this case, one of two innocent persons or classes is to suffer, which should it be,—that one which is brought in to suffer loss, without its consent or power to prevent it, or the one which has created the power and selected the persons to enforce it?

But, after all, the objection to the remedy of this plaintiff against the bank, in its corporate capacity, is not so much, that, as a corporation, it cannot be made responsible for torts committed by its directors, as that it cannot be subjected for that species of tort which essentially consists in motive and intention. The claim is, that, as a corporation is ideal only, it cannot act from malice, and therefore, cannot commence and prosecute a malicious or vexatious suit. This syllogism, or reasoning, might have been very satisfactory to the schoolmen of former days; more so, we think, than to the jurist who seeks to discover a reasonable and appropriate remedy for every wrong. To say that a corporation cannot have motives, and act from motives, is to deny the evidence of our senses, when we see them thus acting, and effecting thereby results of the greatest importance, every day. And if they can have any motive, they can have a bad one,—they can intend to do evil, as well as to do good. If the act done is a corporate one, so must the motive and intention be. In the present case, to say that the vexatious suit, as it is called, was instituted, prosecuted, and subsequently sanctioned by the bank, in the usual modes of its action; and still to claim, that, although the acts were those of the bank, the intention was only that of the individual directors, is a distinction too refined, we think, for practical application.

It is asked, how can the malice of a corporation be proved? It must be proved, it is said, as well as alleged, in an action for a malicious prosecution as a distinct and essential fact; and the declarations and admissions of individual members, whether directors or others, are not admissible to prove it. True, malice must be proved, and, as we suppose, very much in the same manner as it is proved in other cases of a similar nature, against individual persons. The want of probable cause of action is proof of malice, and for aught we know, also, the records of the bank may show it. It is enough to say, in this, as in all other cases, that if the plaintiff cannot, in some legitimate way, prove the malice he has alleged, he cannot recover; but we have no right to assume it as a legal principle, that it cannot be proved. We do not know that it has ever been adjudged that a corporation



is civilly responsible for a libel. But, among the great variety and objects of these institutions, it is probable that the newspaper press has come in for its share of the privileges supposed to be enjoyed under corporate powers. Proof of the falsehood of slanderous charges is evidence of malice, and which must, as in this case, be proved; but, would it be endured that an association, incorporated for the purpose suggested, could, with impunity, assail the character and break down the peace and happiness of the good and virtuous, and the law afford no remedy, except by a resort to insolvent and irresponsible type-setters, and for no better reason than that a corporation is only an ideal something, of which malice or intention cannot be predicated? And, if, as we have suggested, the directors are, for all practical purposes, the corporation itself, acting at least as its representatives, we can see no greater difficulty in proving their motives good or bad, than in thus proving the motives of other associated or conspiring bodies. We are sure, that this objection of the defendants was not discovered, or was not regarded as sufficient, nor the difficulty of proving malice upon a corporation felt, when the case of *Merrills v. The Tariff Manufacturing Co.*, 10 Conn. R. 384, was tried at the circuit, and discussed and decided by this court. That was an action against a corporation for a malicious injury, and the sole question in this court was, whether, by reason of the malicious intent, the company was liable for aggravated or vindictive damages; and it was holden to be thus liable, in a very elaborate opinion, drawn up, and strongly expressed, by Huntington, J.

The interests of the community, and the policy of the law demand that corporations should be divested of every feature of a fictitious character which shall exempt them from the ordinary liabilities of natural persons, for acts and injuries committed by them and for them. Their immunities for wrongs are no greater than can be claimed by others, and they are entitled to an equal protection, for all their rights and privileges, and no more.

For the reasons suggested, a majority of the court is of opinion that the nonsuit granted by the superior court should be set aside, and a new trial granted.

In this opinion, Waite, J., concurred.

## CHAPTER XVII.

## FOREIGN CORPORATIONS.

## MULLER V. DOWS.\*

SUPREME COURT OF THE UNITED STATES, 1876.

(94 U. S. 444.)

*Citizenship of a Corporation.*

Mr. Justice Strong: The decree made below is assailed here for several reasons. The first is that the court had no jurisdiction of the suit, in consequence of the want of proper and necessary citizenship of the parties. This objection was not taken in the Circuit Court, but it is of such a nature that, if well founded, it must be regarded as fatal to the decree. The bill avers that Dows and Winston, two of the complainants, are citizens and residents of the state of New York, and that Burnes, the other complainant, is a citizen and resident of the state of Missouri. The two original defendants, the Chicago and Southwestern Railway Company, and the Chicago, Rock Island and Pacific Railroad Company, are averred to be citizens of the state of Iowa. Were this all that the pleadings exhibit of the citizenship of the parties it would not be enough to give the Circuit Court jurisdiction of the case. In *The Lafayette Insurance Company v. French et al.* (18 How. 404), a similar averment was held to be insufficient, because it did not appear from it that the Lafayette Insurance Company was a corporation; or, if it was, that it did not appear by the law of what State it was made a corporation. It was, therefore, ruled that, if the defective averment had not been otherwise supplied the suit must have been dismissed. A corporation itself can be a citizen of no State in the sense in which the word "citizen" is used in the Constitution of the United States. A suit may be brought in the Federal Courts by or against a corporation, but in such a case it is regarded as a suit brought by or against the stockholders of the corporation; and, for the purposes of jurisdiction, it is conclusively presumed that all the stockholders are citizens of the State which, by its laws, created

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\*See *Stout v. Railroad Co.*, 8 McCrary, (C. C.) 1.

the corporation. It is, therefore, necessary that it be made to appear that the artificial being was brought into existence by the law of some State other than that of which the adverse party is a citizen. Such an averment is usually made in the introduction, or in the stating part of the bill. It is always there made if the bill is formally drafted. But if made anywhere in the pleadings it is sufficient. In *The Lafayette Insurance Company v. French et al.* (*supra*), the defective averment of citizenship was held to have been supplied by the plaintiff's replication to the plea, which alleged that the defendants were a corporation created under the laws of Indiana, having its principal place of business in that State. And, in the present case, we think the averment in the introduction of the bill that the two defendant corporations were citizens of Iowa, which, if standing alone, would be insufficient to show jurisdiction in the Federal Court, has been supplemented by other averments which satisfactorily show that the court had jurisdiction of the case. The bill in its stating part alleges that the Chicago and Southwestern Railway Company, of the State of Iowa, was organized by the adoption of articles of association in the manner provided by the laws of said State, and that, with all the powers, rights and privileges granted and conferred on corporations by the then existing laws of the said state, it assumed to act. The articles of association are appended to the bill as an exhibit, and made part of it by proper reference. So are the articles of consolidation with a corporation of the same name of Missouri, in which the Chicago and Southwestern Railway Company, in Iowa, is cited to be a body politic and corporate, organized and existing under and by virtue of the laws of the state of Iowa. The averments of the bill were generally admitted in the answers of both the defendant companies. But this is not all. Throughout the pleadings the corporate existence under the laws of Iowa of both the companies is either admitted or asserted by all the original parties and by the appellants, who were made parties after the suit had been some time in progress. The petition of the appellants to be made parties adopted another petition in which it was alleged that the Chicago, Rock Island and Pacific Railroad Company was and is a corporation organized under and in pursuance of the laws of the states of Illinois and Iowa, and that the Chicago and Southwestern Railway Company was and is a corporation created under and by virtue of the laws of the states of Missouri and Iowa. Having been made parties, the appellants filed cross-bills against the present complainants and the two companies, in which they repeated the averments they had previously adopted; and the answer to the cross-bill made by all the defendants therein expressly admitted them. The record is thus seen to be full of

showing that both the defendant corporations derived their existence as corporate bodies under the laws of Iowa, at least in part, and that they were corporations of that state.

Still it is argued on behalf of the appellants that the Chicago and Southwestern Railway Company cannot claim to be a corporation created by the laws of Iowa, because it was formed by a consolidation of the Iowa company with another of the same name, chartered by the laws of Missouri, the consolidation having been allowed by the statutes of each state. Hence, it is argued, the corporation was created by the laws of Iowa and of Missouri; and as Burnes, one of the plaintiffs, is a citizen of Missouri, it is inferred that the circuit court had no jurisdiction. We cannot assent to this inference. It is true the provisions of the statutes of Iowa, respecting railroad consolidation of roads within the state with others outside of the state, were that any railroad company, organized under the laws of the state, or that might be thus organized, should have power to intersect, join and unite their railroads constructed or to be constructed in the state or in any adjoining state at such point on the state line or at any other point as might be mutually agreed upon by said companies; and such railroads were authorized to "merge and consolidate the stock of the respective companies, making one joint-stock company of the railroads thus connected." The Missouri statutes contained similar provisions; and with these laws in force the consolidation of the Chicago and Southwestern railroads was effected. The two companies became one. But in the state of Iowa that one was an Iowa corporation, existing under the laws of that state alone. The laws of Missouri had no operation in Iowa. It is, however, unnecessary to discuss this subject further. Doubt in regard to it is put at rest by the decision of this court in *Railway Company v. Whitton's Administrator*, (13 Wall. 270). There a similar question arose. A suit was brought by a citizen of Illinois in the state of Wisconsin, and it became a question whether the federal circuit court of the latter state could entertain jurisdiction. The company sued at first in the state court, resisted an application to remove the case into the United States circuit court on affidavits that it was a corporation created by and existing under the laws of the states of Illinois and Wisconsin and Michigan; that its line of railway was located, in part, in each of these states; that its entire line of railway was managed and controlled by the defendant as a single corporation; that all its powers and franchises were exercised, and its affairs managed and controlled, by one board of directors and officers; that its principal office and place of business was at the city of Chicago, in the state of Illinois, and that there was no office for the control or management of the general business and affairs of

the corporation in Wisconsin. Nevertheless the circuit court took jurisdiction of the case; and this court held correctly, remarking that "the defendant is a corporation, and as such a citizen of Wisconsin by the laws of that state. It is not there a corporation or citizen of any other state. Being there sued, it can only be brought into court as a citizen of that state, whatever its status or citizenship may be elsewhere." In view of this decision it must be held that the objection to the jurisdiction of the circuit court of Iowa is unsustainable.

The next objection urged against the decree of the court below is that it is void so far as it directed the usual foreclosure and sale of property not within the territorial jurisdiction of the court. A part of the Chicago and Southwestern Railway is in the state of Missouri, and the mortgage which the bill sought to have foreclosed covered that part, as well as the part in the state of Iowa. The court decreed a sale of the entire property covered by the mortgage, and directed the master, who was ordered to make the sale, to execute a good and sufficient deed or deeds to the purchaser. It also declared that after the sale both the defendant corporations and the complainants' trustees named in the mortgage, as well as all persons claiming under them or either of them, be barred and foreclosed from all interest, estate, right, claim or equity of redemption of, in, and to the property, reserving, however, the rights of the holders of the bonds and coupons secured by the first mortgage then remaining outstanding and unpaid. It directed that the two defendant corporations should surrender to the purchaser the property sold and conveyed, upon the execution, approval and delivery of the master's deed; and that, as further assurance, the Chicago and Southwestern Railway Company should, on the approval and delivery of the master's deed, convey all the property therein described to the purchaser, by their good and sufficient deed.

If such a foreclosure and sale cannot be made of a railroad which crosses a state line and is within two states, when the entire line is subject to one mortgage, it is certainly to be regretted, and to hold that it cannot be would be disastrous, not only to the companies that own the road, but to the holders of bonds secured by the mortgage. Multitudes of bridges span navigable streams in the United States, streams that are boundaries of two states. These bridges are often mortgaged. Can it be that they cannot be sold as entireties by the decree of a court which has jurisdiction of the mortgagors? A vast number of railroads, partly in one state and partly in an adjoining state, forming continuous lines, have been constructed by consolidated companies and mortgaged as entireties. It would be safe to say that more than one hundred millions of dollars have been invested on the

faith of such mortgages. In many cases these investments are sufficiently insecure at the best. But if the railroad, under legal process, can be sold only in fragments; if, as in this case, where the mortgage is upon the whole line and includes the franchises of the corporation which made the mortgage, the decree of foreclosure and sale can reach only the part of the road which is within the state,—it is plain that the property must be comparatively worthless at the sale. A part of a railroad may be of little value when its ownership is severed from the ownership of another part. And the franchise of the company is not capable of division. In view of this, before we can set aside the decree which was made, it ought to be made clearly to appear beyond the power of the court. Without reference to the English chancery decisions where this objection to the decree would be quite untenable, we think the power of courts of chancery in this country is sufficient to authorize such a decree as was here made. It is here undoubtedly a recognized doctrine that a court of equity, sitting in a state and having jurisdiction of the person, may decree a conveyance by him of land in another state, and may enforce the decree by process against the defendant. True, it cannot send its process into that other state, nor can it deliver possession of land in another jurisdiction, but it can command and enforce a transfer of the title. And there seems to be no reason why it cannot, in a proper case, effect the transfer by the agency of the trustees when they are complainants. In *McElrath v. The Pittsburg and Steubenville Railroad Co.*, 55 Penn. St. 189,—a bill for foreclosure of a mortgage,—in which it appeared that a railroad company, whose road was partly in Pennsylvania and partly in West Virginia, had mortgaged all their rights in the whole road, the court decreed that the trustee who had brought the suit, being within its jurisdiction, should sell and convey all the mortgaged property, as well that in the state of West Virginia as that in Pennsylvania. This case is directly in point, and tends to justify the decree made in the present case. The mortgagors here were within the jurisdiction of the court. So were the trustees of the mortgage. It was at the instance of the latter the master was ordered to make the sale. The court might have ordered the trustees to make it. The mortgagors who were foreclosed were enjoined against claiming the property after the master's sale, and directed to make a deed to the purchaser in further assurance. And the court can direct the trustees to make a deed to the purchaser in confirmation of the sale. We cannot, therefore, declare void the decree which was made.

The next objection urged by the appellants is that the bill for a foreclosure and all the proceedings therein were collusive. It is said the suit was instituted by collusion between the trustees and

the Rock Island and Southwestern Railroad Companies for the purpose of destroying the lien of the Atchinson branch bondholders on the main line of the Southwestern Railway, and to enable the Rock Island Company to obtain the title to the main line, discharged from any lien or claim on the part of such bondholders. After careful examination of the evidence we have failed to find anything that justifies this objection. And certainly, if there was collusion in bringing and conducting the suit, the appellants have not been injured by it. They were permitted to come in as parties defendant, and they had full opportunity to assert their equities.

The fourth objection is general. It is that at the time of filing the bill no right of foreclosure existed in favor of the complainant trustees for the benefit of the Chicago and Rock Island Railway Company, or if such a right did exist that it had been waived. In respect to this objection we have to remark that unless the right to a foreclosure had been waived by the Rock Island Company we discover no foundation for the assertion that there was no right of foreclosure when the suit was brought. That company had indorsed \$5,000,000 of the bonds of the Southwestern Company secured by the mortgage; and, in consequence of the indorsement, had paid coupons for interest of the bonds to a large amount. The mortgage stipulated that it might be foreclosed, in case of failure by the mortgagor to pay the interest; and it stipulated further that in case the Rock Island Company should, in consequence of its guaranty, pay any of the bonds or coupons, the mortgage might be foreclosed at their instance. The right to foreclose at the instance of the Rock Island Company was expressly given. Was there any waiver of this right? We think not. It is said that the contract of July 27, 1871, coupled with the contract of Oct. 1, 1869, constituted a waiver. The contract first made preceded and contemplated the execution of the mortgage. It gave to the Rock Island Company the option of furnishing the equipment for the Southwestern road, or to lease and operate it on such terms as might be agreed upon. Manifestly this was for an additional security to the guarantors of the bonds, and not for a substituted security. And the contract of July 27, 1871, made between the Rock Island Company and the Southwestern, merely provided that, with regard to the lease of the branch railroad proposed to be constructed by the latter to the Missouri River, opposite Atchinson, it should be used and operated by the Rock Island road in the same manner and on the same terms as the main line of the Southwestern. The meaning of this is not that a lease existed or should be taken, though one may have been contemplated, but that the branch road should be operated in the same manner and on the same terms as

the main line might be. How this contract alone, or connected with the contract of Oct. 1, 1869, can be construed as a waiver of a right to sue for foreclosure of the mortgage on the main line we are unable to comprehend. Nor can we see that the contract of Dec. 4, 1871, called a "lease contract," even if it be regarded as an executed and subsisting contract, can have such an effect. We have heretofore said that the agreement to give and take a lease, dependent on the option of the Rock Island Company, was intended as an additional security to that company for its endorsement of the bonds. If we are correct a lease executed in pursuance of the agreement could be only cumulative security. Hence it could be no waiver of the right to foreclose.

But, in fact, there was no lease, nor any agreement for a lease that could be enforced specifically. The language of the agreement of Oct. 1, 1869, and that of the agreement of July 27, 1871, warrant no interpretation that makes them a lease in law or in equity. The first, it is true, contemplated the possibility of a lease of the main line, if the terms could be agreed upon; and the latter provided that when such lease should be agreed upon, if ever, it should also embrace the branch line. But the terms never were agreed upon. On the thirtieth day of October, 1871, at a meeting of the executive committee of the Rock Island Company, Messrs. Scott and Riddle were appointed a sub-committee "to agree upon the basis of a contract for a running arrangement between the company and the Southwestern, with directions to report to the general committee when an arrangement should be agreed upon." On the fourth of December, 1871, a proposition was submitted by that sub-committee to the officers of the Southwestern and accepted by them. It was a proposition for a lease. But the sub-committee had no authority to agree for the Rock Island Company to take a lease, and when afterwards they reported their action to the general committee that committee refused to confirm it. It is vain, therefore, to contend that there was a lease, or any agreement for a lease, that can be enforced. And, even if there was, there is no evidence that one of its terms was that the rent should be sufficient for the payment, and should be applied to the payment of the Atchinson branch bonds.

It is next insisted on behalf of the appellants that the Rock Island Company could not ask for a foreclosure of the mortgages until it had accounted for and applied the stock of the Southwestern Company to its indemnification for its guaranty, for which purpose it held such stock as security. The company did hold a large amount of that stock. Whether it held it as an indemnity for the liabilities it had assumed we do not care to inquire. Assuming that it did, the fact is quite immaterial. It surely cannot be maintained that a surety who held several securities for his in-



demnity cannot use one of them because he has another to which he might resort.

The fifth particular in which the decree is alleged to have been erroneous is that it denied the relief for which the appellants prayed in their cross-bill. That relief was the enforcement of what is called the lease contract of Dec. 4, 1871, or the enforcement of the contract of July 27, 1871, by a lease of the branch line on terms and conditions to be derived from the contract of Oct. 1, 1869; that is to say, the rental to be paid by the Rock Island Company to be an amount sufficient to guarantee the principal, or at least the interest, of the Atchinson branch bonds. The answer to this is what we have heretofore said. There was no lease, nor any contract which bound the Rock Island Company to take a lease, much less to pay a rental sufficient to guarantee the principal or interest of the Atchinson branch bonds or to apply the rent to the payment of that principal or interest.

The appellants also, in their cross-bill, prayed in the alternative that the bonds of the branch road held by them might be deemed to have been obtained under false and fraudulent pretences, and that the proceeds thereof were paid out by the Rock Island Company knowingly, fraudulently and in violation of a trust assumed by them, and that the said company might be decreed to pay to them the par value of the same and interest.

We have sought in vain for any evidence that would justify a decree that the Rock Island Company obtained the bonds of the branch road by fraudulent pretences, or that it knowingly, fraudulently and in violation of any trust assumed by it, paid out the proceeds of sale of the bonds. By the provisions of the branch mortgage the Rock Island Company was made the custodian of the bonds, with power and direction to pay them and their proceeds to the president or other duly authorized agent of the Southwestern Company, in three contingencies: First, upon the delivery of an invoice of articles purchased, approved by the president; second, upon the presentation of monthly estimates by the engineer of the Southwestern of work done and materials furnished in the construction of the branch railway, approved in the same manner; and third, on the certificate of the same engineer, approved in like manner, that the road had been completed and was in running order. If this constituted a trust, it was only that of a custodian. The Rock Island Company had no right to control the location of the branch road or the cost of its construction. It was not its duty to supervise the contracts or direct the alignment. Such action would have been outside of its corporate power. If some persons who were its officers undertook to control the expenditure in such a manner as to secure a proper location and construction of the road (of which we dis-

cover no sufficient evidence), those persons may be responsible for their breach of duty, if there was any. But no such trust was assumed by the Rock Island Company. Certainly, then, there was no undertaking that the branch road should be fifty miles long; and if it was imperfectly constructed it appears that the Rock Island Company has expended upon its construction a very large sum of its own money, and has made it a first-class western road. If, then, there was such a trust as is charged by the appellants, and a breach of it, full compensation has been made, and the appellants have all the security the trust was intended to give them; *i. e.*, a first mortgage upon a finished first-class road.

The last objection to the decree is that the relief prayed for by the cross-bills of the two defendant railroad companies should not have been granted for the following reasons: 1st. If the original suit fails for want of jurisdiction, so must the cross-bills. 2d. The cross-bills were nullities, because filed without leave of the court, and because not making the intervening bondholders parties. 3d. Because collusive. We have seen the court had jurisdiction of the original suit. The permission of the court to file the cross-bills must be presumed from its action upon them, and the intervening bondholders were not parties or necessary parties when the bills were filed. They became parties to the original bill, but they did not ask to be made parties to the cross-bills of the defendant corporations. That the cross-bills were collusive in their origin, purpose and conduct, if such was the fact, which we do not perceive, is of no importance, since the appellants had an unobstructed opportunity to vindicate their rights. They might, if they had chosen, have become parties defendant to the cross-bills, and if they had, they could not have resisted the relief given by the court.

The appellants are, no doubt, unfortunate. It may be that they purchased their bonds, expecting that the Rock Island Company would protect them, either by taking a lease of the branch road or by holding the purchase-money of the bonds and expending it for their security. But the expectation of a guaranty cannot be treated as a guaranty itself. Decree affirmed.

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WILLIAMSON V. SMOOT.

SUPREME COURT OF LOUISIANA, 1819.

(7 Martin O. S. (La.) 31.)

Mathews, J.: The plaintiffs having caused an attachment to be

levied on the steamboat Alabama, the St. Stephens Steamboat Company intervened in their corporate capacity, and claimed her as their property. The intervening party are a body politic, created by an act of the legislature of the territory of Alabama, the capital stock of which is divided into shares of a certain amount, and Smoot, the defendant, owns ten of them, subscribed for by him.

The questions to be decided are: 1. Is it proper for our courts of justice to recognize, in their judicial proceedings, the company as a corporate body? 2. Can the shares of stock of any individual stockholder be legally attached?

I. The propriety or legality of one sovereign state acknowledging and favoring the rights and privileges of political bodies of another state are opposed on the ground of their being in violation of the sovereignty of that which recognizes the acts of incorporation of the other, and to the prejudice of the rights of its citizens. It does not appear to this court that these things will of necessity result, in every case, from such acknowledgment and recognition. When attempts directly opposed to the sovereign power of a state and the rights of its citizens are made by the political bodies of another they certainly ought to be repelled, and so ought such if made by corporations deriving their existence from the government under which they act. But as the present claim of the St. Stephens Steamboat Company is not of this nature, we are of opinion that they ought to be allowed to prosecute it in their corporate capacity.

II. The existence of the claimants being recognized as a body corporate, and it being admitted that the boat attached belongs to them as a part of their common stock, it is clear that Smoot does not possess such certain and distinct individual property in it as to make his interest attachable. The estate and rights of a corporation belong so completely to the body that none of the individuals who compose it has any right of ownership in them, nor can dispose of any part of them (Civ. Code, 88, art. 11).

The court is of opinion that the district court erred in disallowing the claim of the company.

It is, therefore, ordered, adjudged and decreed that the judgment be annulled, avoided and reversed, and that the attachment of the plaintiff and appellant be quashed, so far as it relates to the said steamboat, the Alabama, and that she be released therefrom.

## CHAPTER XVIII.

## ACTIONS.

## YOUNGLOVE V. LIME CO.\*

SUPREME COURT OF OHIO, 1892.

(49 Ohio St. 663.)

*Action to Enforce Statutory Liabilities—Statute of Limitations.*

By the Court: As a general rule, the creditors' right of action against the stockholders of a corporation is not complete, so as to set the statute of limitations running, until judgment has been recovered against the corporation, and execution has been returned without satisfaction. The reason is, the corporate property is the primary fund for the payment of the debts of the corporation, and the statutory liability of the stockholders a security which can be resorted to only after the creditors' remedy against the corporation has been exhausted. When, however, the corporation has done, or suffered to be done, any act which would render judgment and process against it of no avail, as where its property has been placed in the hands of an assignee in insolvency or bankruptcy, or by the appointment of a receiver, or dissolution of the corporation, or some other legal proceeding, its property has been put in process of application to the payment of its debts, the creditors may proceed against the stockholders without first putting their claims in judgment against the corporation. *Morgan v. Lewis*, 46 Ohio St. 1, 17 N. E. Rep. 558; *Barrick v. Gifford*, 47 Ohio St. 180, 24 N. E. Rep. 259; *Bronson v. Schneider*, 49 Ohio St. 438, 33 N. E. Rep. 233.

In such cases the insolvency of the corporation is as effectually established, and the creditor's remedy as fully exhausted, as they would be by the return of an execution issued against it, unsatisfied in whole or in part. The creditor need not wait final settlement or distribution by the assignee or receiver, or other officer charged with that duty, but may at once commence his action against the stockholders. The action is an equitable one, in which all the creditors and stockholders must be parties, and the court

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\**Bronson v. Schneider* (O.), 33 N. E. Rep. 233; *Hardman v. Sage* (N. Y.), 36 Am. & Eng. C. C. 146, note; *Barrick v. Gifford* (O.), 31 Am. & Eng. C. C. 484.

may withhold final judgment until the exact amount each stockholder should pay can be ascertained, or so mould its decree as to require these several stockholders to pay their proper proportion of the liabilities remaining after the application of all the assets of the corporation towards their satisfaction, and retain control over the cause and the parties until their ultimate rights shall be determined and adjusted. But the creditors' right of action against the stockholders does not accrue when the corporation becomes insolvent, in the sense, simply, that its property is insufficient for the payment of its liabilities; and it was the insolvency of the corporation, in that sense, as we understand the record, which the circuit court held set the statute of limitations running against the plaintiff below. The facts, as found by that court, with respect to the insolvency of the Kelly Island Lime Company, are, in substance, that since the 1st of January, 1878, it has been unable to pay its debts; and on the 18th of August of that year the receiver, who had carried on the business of the company from 1875 to that time, was discharged, and the property and business of the company restored to it, by the order of the court which appointed the receiver; and thereafter the company continued in the possession of its property and control of its business until after the 28th of August, 1878, when creditors of the corporation commenced proceedings in bankruptcy against it, in which it was on the 16th of February, 1880, adjudged a bankrupt, and its property transferred to the assignee then appointed in that proceeding. If the receiver was appointed because of the insolvency of the company, to wind up its affairs, the statute, no doubt, would run from that time in favor of the stockholders. There is no express finding that he was or was not so appointed; but any inference that his appointment was for the cause or purpose named is inconsistent with the fact that for nearly three years he carried on the business of the company under the direction of the court, and then, by its order, restored the business and property to the company, and the further fact that the insolvency of the company, as found by the court, dates from the 1st of January, 1878, long after the receiver was appointed. The inference from these facts would rather be that the receiver was appointed to carry on the business, in order to accomplish some purpose of its stockholders or directors, and not on account of its insolvency, and that its property and business were returned to it, either because there was no authority for the appointment of the receiver, or because the purpose of his appointment had been fully accomplished. At all events, from the termination of the receivership to the filing of the petition in bankruptcy, there was no obstruction to the creditors pursuing their remedy against the corporation. But we think the proceeding in bankruptcy

dispensed with the necessity of any action against the corporation, and entitled the creditors, without judgment and execution against it, to sue the stockholders. The statute of limitations commenced to run in behalf of the latter from that time; and, as less than six years had elapsed when the plaintiff commenced his action, it was not barred.

Judgment reversed, and judgment for plaintiff below.

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### HANNERTY V. STANDARD THEATER CO.\*

SUPREME COURT OF MISSOURI, 1892.

(19 S. W. Rep. 32.)

*Stockholders Right to Sue to Protect His Rights—Necessity for a Demand on Directors.*

Black, J.: The plaintiff is a shareholder in the Standard Theater Company, and the defendants are James Butler, Edward Butler, Jr., and Edward Sullivan, directors, and Edward Butler, Sr. The corporation is also a defendant. The petition, in general terms, prays for a decree reinstating a forfeited lease; that Edward Butler, Sr., be required to convey the fee in the leased property to the corporation; for an accounting; and the appointment of a receiver, etc. The Standard Theater Company was incorporated on the 12th May, 1883, with a capital stock of \$30,000, which stock was increased to \$50,000. Edward Butler, Sr., became the owner of 240 shares, and Joseph H. McIntyre became the owner of 150 shares, of the par value of \$100 each; the other 110 shares were not sold. On the 15th May, 1883, the company procured a lease from John H. and Charles H. Bobb for a term of 100 years, on a lot in the city of St. Louis, subject to various conditions. Among other things, the lessee, the theater company, agreed to pay rents for the first five years at the rate of \$2,500 per annum; the rents for the first year to be paid at the end of that year, and thereafter quarterly. The lease provides further that the rent for the second and each subsequent period of five years shall be fixed at 6 per centum per annum on the value of the ground, excluding buildings thereon, but never to be less than \$2,500 per annum. Stipulations are then made concerning the appointment of appraisers, should the parties not agree upon the value of the

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\*Chicago Hansom Cab Co. v. Yerkes, Supreme Court of Ill. 1892. Smith v. Dorn, Colo. 92.

land. The lease secures to the lessee the right to purchase the property at any time within five years next after June 1, 1883, at the price of \$50,000. The lessors have the right to declare a forfeiture of the lease for the non-performance of any of the conditions, and in case of forfeiture the lessors or their assigns become entitled to the possession of the premises and buildings thereon free from any claim of the lessee or its assigns, provided, however, that no forfeiture shall be had for non-payment of rent until the same shall have been due for 30 days. The theater company erected a building on the leased lot, and conducted a theater business there. McIntyre became dissatisfied with the business, and in 1885 sold his 150 shares of stock to the plaintiff, Hannerty, for \$3,500. Hannerty became a director and the treasurer, and took an active part in the management of the business. At this time the directors were Edward Butler, Sr., Hannerty, and James J. Butler. The latter then held 10 shares of stock, which had been transferred to him by his father, Edward Butler, without any money consideration paid therefor. Some time prior to the 29th of June, 1887, Edward Butler transferred 10 shares of stock to his son, Edward Butler, Jr., and 10 shares to his clerk, Edward Sullivan. Both of these transfers were without consideration paid for the stock so assigned. The directors elected on the last-mentioned date were Edward Butler, Sr., James J. Butler, and Edward Sullivan. The following resolution was adopted at a special meeting of the stockholders, held on the 21st May, 1888: "It appearing to the stockholders that the company was not in a condition to purchase said property, on motion of James J. Butler, duly seconded and carried, the right, power, and authority was conferred by the stockholders on the board of directors to use their discretion in disposing of said option, and to take any action with reference to the same that they might believe to be for the best interest of the company, and to do what they thought right and proper in the premises; and, if they saw fit, to sell and dispose of said option to any stockholder in said company who would pay the highest price for same." The record made of this meeting shows that Hannerty was present. He testified that he received notice of the meeting; that the meeting was called to order by Edward Butler; that he then asked Sullivan, the secretary, whether there was enough on hand to pay the rent; that Sullivan smiled, and said "No;" that he waited about two minutes longer, and they said the meeting was adjourned, and he left; and that no such a resolution was passed before the adjournment was proclaimed; but several of the defendants say he was present during the entire meeting. The proof, all considered, satisfies us that Hannerty was present when this resolution was adopted. On the

same day—May 21, 1888—the board of directors met, and made an order transferring the company's option for the purchase of the property to Edward Butler, Sr., for the consideration of \$50. At this time Edward Butler, Sr., James J. Butler, and Edward Sullivan constituted the board, all of whom were present. On the same day Edward Butler, Sr., handed to the secretary his resignation as president and director, which was accepted on the 28th of the same month; and the other members of the board elected Edward Butler, Jr., to fill the vacancy. Thereupon Edward Butler, Sr., purchased the property at the price of \$50,000, and received a deed therefor from the lessors and their grantees, "subject to said lease and to all the covenants" therein contained. On the 30th of the same month the directors entered into an agreement with Edward Butler, Sr., fixing the value of the lot at \$65,000 for the period of five years beginning on the 1st June, 1888, and the rental at \$3,500 per annum. The stockholders, at a meeting held on the 28th June, 1888, elected the following directors; James J. Butler, Edward Butler, Jr., and Edward Sullivan. At this election the stock was voted as follows: Edward Butler, Sr., 210 shares; James J. Butler 10 shares; Edward Butler, Jr., 10 shares; Edward Sullivan, 10 shares; and James Hannerty, 150 shares. Hannerty voted for himself, but was defeated. The new board met on the same day, and elected James J. Butler president, with an annual salary of \$2,500, and Sullivan secretary and treasurer, with a salary of \$1,200 per year. This new board of directors failed to pay the \$625 rent due on the 31st May, 1888, and the \$875 rent due on the 31st August, 1888. In the following October, Edward Butler, Sr., as lessor and owner of the land, declared a forfeiture, and thereupon obtained a judgment against the corporation by default in a forcible detainer suit before a justice of the peace. He was placed in possession with due solemnity under a writ issued upon this judgment, and the officers and agent of the corporation then became his agent in the conduct of the theater.

1. We may here dispose of that branch of the case which seeks to compel Edward Butler, Sr., to convey the reversion in the leased property to the corporation, the corporation assuming the payment of the purchase price. This relief is asked on the averments that the corporation had the means to purchase the property, but that the directors, conspiring with him, fraudulently assigned to him the company's option to purchase the fee, secured by the lease. This right or option secured to the company to purchase the reversion for \$50,000 was assigned to Mr. Butler on the 21st May, 1888,—10 days before it expired. Conceding that his will ruled the then directors, though he



resigned his office of president and director a few days before he took this assignment and purchased the property from the lessors, still all this does not deprive him of the benefit of his investment. It is true, directors of a corporation occupy a position of trust, and their dealings with the subject-matter of the trust will be watched with a jealous eye by the courts. Here it required \$10,000 cash to make the purchase under the stipulation in the lease. The company did not have that amount of money, nor did it have the credit to raise so large a sum. The option was of no value to the company. Though we treat Mr. Butler as still being the president and a director of the corporation, still he certainly had a right to buy the reversion in the property upon which the corporation held the leasehold interest, unless the purchase deprived the corporation of some rights. As the corporation could not avail itself of this option to purchase the property, there can be no valid objection to the purchase of it by him. He purchased the property subject to the lease, and must be held to be the owner of it, subject to whatever rights the corporation may have had as lessee.

2. We are next to consider that branch of the case wherein it is claimed the forfeited lease should be reinstated, and the defendants required to account. The objection is here made by the defendants that the plaintiff cannot maintain this suit, because he does not aver that he first requested the corporation to institute and prosecute it. The cause of action for the violation of a corporate right accrues to the corporation, and not to the stockholders, and generally the remedy must be obtained by and in the name of the corporation. The directors are the managing officers, and it is for them to say whether a given suit shall be prosecuted. *Slattery v. Transportation Co.*, 91 Mo. 217, 4 S. W. Rep. 79. There are, however, exceptions to the rule. Thus a stockholder may sue in those cases where the directors are guilty of a fraud or breach of trust, or are proceeding *ultra vires*. These, at least, are some of the exceptions to the general rule. *Hawes v. Oakland*, 104 U. S. 450. Directors are liable to the corporation for a breach or abuse of their trust, and may be compelled to account for corporate funds thus abstracted or misapplied. If other persons have participated with them, such persons may be joined as defendants, and the property may be followed into their hands. But in all of these cases it must appear that the proper officers refuse to prosecute the suit, or that the corporation is under the control of persons who were parties to the fraud or abuse of trust. It is sufficient to entitle the stockholder to sue to show that the corporation is under the control of directors who are liable for the loss. *Smith v. Poor*, 40 Me. 415; *Ashton v.*

Association, 84 Cal. 61, 22 Pac. Rep. 660, and 23 Pac. Rep. 1091; Pike Co. v. Hammons, (Ind. Sup.) 27 N. E. Rep. 487; Hodges v. Screw Co., 1 R. I. 340. "There are," says Cook, "occasions when the allegation that the stockholder has requested the directors to bring suit, and they have refused, may be omitted, since the request itself is not required. This occurs when the corporate management is under the control of the guilty parties. No request need then be made or alleged, since the guilty parties would not comply with the request; and even if they did, the court would not allow them to conduct the suit against themselves." Cook, Stock, § 741. Now, the directors of this corporation are the persons who are charged with mismanagement of the corporate property. The corporation is still under their control. It was therefore not necessary to allege or prove a demand upon them to institute this suit. Under these circumstances, such a request was not necessary.

3. We therefore come back to the question whether the lease should be reinstated. The substantial averments on which this relief is asked are that the corporation was doing a prosperous business, and had means to pay the rents as they accrued, but that the directors, James J. Butler, Edward Butler, Jr., and Edward Sullivan, by the influence of Edward Butler, Sr., failed and omitted to pay them; that they allowed a forfeiture of the lease for the purpose of defrauding the plaintiff out of his interest as a stockholder. The first inquiry, therefore, is whether the directors could and should have paid the rents. The rents for the non-payment of which a forfeiture was declared became due as follows: \$625 on 31st day of May, 1888; \$875 on August 31, 1888. The forfeiture was declared by Edward Butler, Sr., about the first of the following October. The trial court made an order upon the defendants to produce the books of account of the Standard Theater Company from its organization, in 1883, to October, 1888, and upon Edward Butler, Sr., to produce his books showing receipts and expenditures of the theater since the last mentioned date. Pursuant to this order the plaintiff and his expert book-keeper were allowed to examine the account-books of the corporation covering a period from 1883 to and including 1886. The defendants then made return to the order of the court that the account-books from 1885 to and including 1886 were in the possession of the plaintiff; that the defendants had no other books called for by the order; and Edward Butler, Sr., made return that he had and kept no accounts of the theater business since October, 1888. The defendant Sullivan, called to the witness stand by the plaintiff testified that he took the account-books of the Standard Theater Company covering the period from 1883 to October, 1888, to the blacksmith shop

of Ed. Butler and son, and placed them in a closet at that place; that he did not know what had become of the missing books; and though he kept the accounts, he could not state what the receipts and expenses were. The other defendants were also examined by the plaintiff, and their evidence is that they know nothing about the missing books. They could not state how the accounts stood for 1887 and 1888. Hannerty, the plaintiff, says he made frequent demands of Sullivan, the secretary and book-keeper, for a statement of the finances of the company; but that Sullivan always put him off. These demands were made before the commencement of this suit. The plaintiff put in evidence, as a last resort, a copy of the bank-account of the company, from which it appears a check was drawn on and paid by the bank on the last of February, 1888, for \$3,500,—an amount in excess of the checks as they were usually drawn. The defendants, though interrogated at length, could not give any account of this check, or for what purpose the money was used. This bank-account shows a credit to the company on the 22d May, 1888, of \$1,526.06. This was but nine days before the installment of \$625 rent became due. Of that balance, \$1,029.56 was checked out on the day before the rent became due. What use was made of this money so checked out the defendants cannot say. The company seems to have had a balance to its account in bank as late as October 31, 1888. There is some other evidence tending to show that this company was doing a fair business. The defendants were directors of this corporation, and as such trustees it was their duty to keep correct accounts, and to be able to make a full and correct showing of the receipts and expenses. Instead of this, we find a manifest disposition on their part to keep back and out of view the true financial condition of the corporation. We think there is but one conclusion to be drawn, and that is this: that these directors could and should have paid these rents. It is equally clear that they intentionally permitted a forfeiture of the lease, and a consequent loss of the entire corporate property, costing at least \$30,000.

Was the defendant Edward Butler, Sr., a party to this breach of trust? To answer this question it is but necessary to recall some of the undisputed evidence. Hannerty, though holding 150 shares of stock, was pushed aside in June, 1887. The directors elected at that time were Edward Butler, Sr., James J. Butler and Sullivan. The latter and James J. Butler each held 10 shares of stock, assigned to them without consideration, and for the evident purpose of qualifying them to act as directors. In May, 1888, Edward Butler, Sr., resigned, and his son, Edward, Jr., to whom 10 shares had been transferred without consideration, became a director. At this date the fee in the leased prop-

erty was purchased by Edward Butler, Sr., for \$50,000. This new board at once agreed with him that the property was of the value of \$65,000, for the purpose of fixing rents under the lease for the second period of five years. These same three directors are again elected on the 28th June, 1888, and they allow James J. Butler a salary of \$2,500 per year for holding the nominal position of president. Sullivan had previously performed the duty of book-keeper and secretary for \$7 per month, but at this time he was allowed a salary of \$1,200 per annum. These liberal allowances to persons who gave but little, and were expected to give but little attention to the business, need an explanation, not given by the evidence before us. There is evidence that Edward Butler, Sr., after this election of directors, and after he had acquired the reversion in the leased land, sold his remaining 210 shares to his son, Edward, Jr., at 25 cents per share. From this evidence, and some other circumstances, there can be no doubt but this new board of directors simply executed and voiced the will of Edward Butler, Sr. It certainly is not expected that this court can reach any other conclusion. And it is equally clear that the directors allowed the lease to be forfeited to enable him to acquire all the corporate property. It was probably supposed that the directors had a right to do this because a majority of the stock so dictated; but the law is not now, and it is hoped never will be, so written. It was the plain duty of the directors to protect and preserve the corporate property for the minority as well as the majority of stockholders. The trial court dismissed the petition on final hearing. That judgment is now reversed, and the cause remanded. The trial court is hereby directed to enter up a decree re-establishing and reinstating the lease. That court will also proceed to take an account of the receipts of the theater property, and of the expenses of conducting the business, including as expenses, rents due on the lease. The court, in stating the account, will go back to 2d July, 1887. The order of the board of directors made on the 30th May, 1888, allowing salaries, will be disregarded. As the case now stands we can go no further in directing subsequent proceedings, more than to say this: that the company will be reinstated as lessee, and the defendants must account to it for all moneys received from 2d June, 1887, to date of final hearing, and the court will then make such further decree as the equity and justice of the case may demand.

## UMSTED V. BUSKIRK.

SUPREME COURT OF OHIO, 1866.

(17 Ohio St. 114.)

*Enforcement of Statutory Liabilities.—Parties.*

White, J.: The original petition in this case is in the nature of a bill in equity, and if filed by a judgment creditor of an insolvent corporation, to obtain satisfaction of his judgment, by the enforcement of the statutory liability of the several stockholders, and of the liability of one of them on an unpaid stock subscription.

No objection is made on the ground of a defect of parties, and, for aught that appears in the record, the plaintiff is the only creditor, and the defendants the only stock holders of the corporation.

The only ground assigned for the demurrer is, that the petition does not contain facts sufficient to constitute a cause of action.

The corporation of which the defendants are stockholders, was organized under the act of May 1, 1852; and the liability of the stockholders in question, is provided for in section 78, which, as originally passed, is as follows:

"The stockholders of any railroad, turnpike, or plank-road, magnetic telegraph, or bridge company, shall be deemed and held liable to an amount equal to their capital stock subscribed, in addition to said stock, for the *purpose of securing the creditors of such company.*" 50 Ohio L. 296; 3 Curwen's Stat. 1897.

The subsequent amendment of April 17, 1854, did not alter the section in respect to railroad companies. 1 S. & C. Stat. 310; 4 Curwen's Stat. 2582.

The counsel of the defendant in error claims to support the judgment below on the ground that it was not the intention of the legislature "to make the stockholders in railroad companies *individually liable to the creditors of the company;*" but that as stockholders they are subject to be assessed *pro rata* by the corporation to the extent of this statutory liability.

This claim was made in *Wright et al. v. McCormack et al.* (decided at the present term), and overruled. It was held in that case that this liability of stockholders was a security provided by law for the exclusive benefit of the creditors, over which the corporate authorities had no control.

If the corporation has the right to enforce this liability by assessments, it can exhaust it to discharge a present indebtedness, and continue in business with no other security to its future creditors than its corporate liability.

This would neither be in accordance with the design of the constitutional provision, nor of the statute. The intention, doubtless, was to provide an ultimate security to which the creditors might resort on the failure and insolvency of the corporation.

Nor will it follow, as counsel suppose, from the denial of the right to the corporation of enforcing this liability, that it may be enforced against part of the stockholders, at the election of the creditor, without the right on their part to call on their co-stockholders for contribution.

The liability on the part of the stockholders is several in its nature, but the right arising out of this liability is intended for the common and equal benefit of all the creditors. The suit of a creditor under this statute should, in our opinion, be for the benefit of all the creditors; and the stockholders, whose liability it is sought to be enforced, have the right to insist on their co-stockholders being made parties for the purposes of a general account, and to enforce from them contribution in proportion to their shares of stock.

The right of contribution grows out of the organic relation existing among the stockholders, as between them and the creditors, each stockholder is severally liable to all the creditors; as between themselves, each stockholder is bound to pay in proportion to his stock.

The corporation ought to have been made a party, but the omission was not made an objection, and the demurrer was sustained, and the action dismissed, on the sole ground of the petition not showing a cause of action against the defendants.

The omission to make the corporation a party is, therefore, no objection to the reversal of the judgment.

The judgment sustaining the demurrer and dismissing the action is reversed, and the cause remanded for further proceedings.

## CHAPTER XIX.

## INSOLVENCY AND DISSOLUTION—REMEDY OF STATE FOR UNAUTHORIZED ACTS BY CORPORATIONS.

## TOMLINSON V. BRICKLAYERS' UNION.

SUPREME COURT OF INDIANA, 1882.

(87 Ind. 308.)

Howk, J.: The only question presented for decision by the record of this cause and the error assigned thereon is this: Does the complaint of the appellants, the plaintiffs below, state facts sufficient to constitute a cause of action? In their complaint the appellants alleged, in substance, that on or about the 28th day of August, 1867, they and others formed a voluntary association, known as and named "The Bricklayers' Union of Indianapolis;" that the objects of the association were to unite all practical bricklayers, so as to secure concert of action in whatever tended to their interests, and to afford pecuniary aid to the members thereof, when disabled from sickness, accident or misfortune; that immediately upon the organization of the association a code of by-laws and constitution were adopted, fixing the amount of dues, fines and assessments payable by each member of the association; that from 1867 to April, 1879, some five hundred or more members joined the association, among whom were the appellants, and each and all paid their money in dues, fines and assessments, which money was placed in one general fund, until, in April, 1879, the same amounted to the sum of about eight thousand dollars, belonging to said members as a joint and general fund for the benefit of each and all of them; that after the association had been duly incorporated the appellants and many others, for whose benefit the appellants sued, to the number of five hundred, made and adopted the by-laws and constitution governing the association; that since such organization, and before, the appellants, each and all, and about four hundred others, whose names could not be given, because they were in books of which the appellee had control, contributed different amounts, and the same were under the control of the association, in trust for the appellants and the other members of the association, in which they all had a general interest; that the association continued until about April, 1879, when a few of its members, twenty in number, without the knowledge, consent or approval, or

the legal right so to do, unlawfully, wrongfully and secretly abandoned and pretended to dissolve the said corporation, and pretended to form a new association, to be known as "The Bricklayers' Union No. 1, of Indiana," the appellee, and as soon as the pretended new organization was formed they secretly, unlawfully and wrongfully converted the said fund of the appellants and other members of the old association to the use of the appellee, and the same was then in their or its possession; and the appellee, although often requested, refused to pay the same to the appellants and the other members of the old association, and refused to allow the appellants and other members of the first organization to participate in the new organization, and refused them all rights of property therein, and claimed that the appellants and those for whom they sued were not members thereof, and claimed the said fund as their own, and refused the appellants any and all benefits therefrom; that at the time of said conversion and pretended dissolution, and the formation of the pretended new organization, the appellants and many others, for whom they sued, were members in good standing of the old association; and that the defendants had also unlawfully converted all the lodge furniture and personal property, of the value of three hundred dollars, without right and wrongfully to their own use, and then had possession thereof.

The appellants further alleged that the appellee had forfeited its charter and corporate right by refusing to allow them to participate in the new organization; and in this, that less than a quorum had pretended to transact business; and in this, that its president had allowed money to be drawn contrary to its constitution; and in this, that the recording secretary had failed to keep a correct record of the transactions of each meeting, and to make a quarterly report of such transactions, and to deliver to his successors the books, records and property of the appellee; and in this, that its financial secretary had failed to discharge his duties and been allowed to continue in office; and in this, that its members were allowed to remain in good standing without paying dues, etc.; and in this, that its treasurer had failed to discharge his duties; and in this, that its trustees had converted the above described property of the old association to the exclusive use of appellee; and in this, that it had used the money for other and different purposes than that specified in its constitution; and in dissolving the union contrary to the terms of its constitution. Wherefore, etc.

We are of the opinion that the appellee's demurrer, for the want of facts, was correctly sustained to the appellant's complaint. Conceding all the facts stated in the complaint to be true as alleged, they constitute no cause of action in favor of the appel-



lants and against the appellee. It will be seen that the wrong conversion of the money and property of the first corporation is alleged to have been committed by its twenty seceding members, who were not made parties to this action. The complaint fails to show the appellee's liability for this wrongful conversion to the plaintiff's in this action. It is not alleged that the old corporation was dissolved in any legal manner, and it cannot be said, we think, that the secession of twenty members would or ought to work the dissolution of a corporation having five hundred members. If the old corporation is still a legal entity, and it must be presumed to be such, at least until the contrary is shown, the right of action for the wrongful conversion of its money and property would be in such old corporation, and not in any of its members, however numerous they were, for the money and property of a corporation belong to it, and not to its individual members. It follows, therefore, that the complaint does not state a cause of action in favor of the appellants for the wrongful conversion of the money and property described therein.

It seems to us, also, that the allegations of the complaint in relation to the forfeiture of appellee's charter do not constitute a cause of action in favor of the appellants. If it were true that the appellee and its officers and members had violated every section of its by-laws and constitution, it is certain, we think, that such violation would not give the appellants any right of action or legal cause of complaint against the appellee, for it was not shown that the appellants were members of the appellee corporation.

We have found no error in the record. The judgment is affirmed, with costs.

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## STATE V. MINNESOTA THRESHER MANUFACTURING CO.

SUPREME COURT OF MINNESOTA, 1889.

(40 Minn. 213.)

### *Manufacturing and Other Business—"Franchises" and "Powers"— Remedy for Altra Vires Acts.*

Mitchell, J.: \* \* \* \* The corporation of Seymour, Sabin & Co., organized under Gen. St. 1878, title 2, c. 34, had been engaged for some years in the business of manufacturing, lumbering, and merchandising. In May, 1882, the Northwestern Manufactur-

ing & Car Company was organized as a manufacturing corporation, under Laws 1873, Gen. St. 1878, Ch. 34, §§ 120, 143, with a professed paid-up capital stock of about \$4,500,000, viz., about \$3,000,000 preferred stock, and \$1,500,000 common stock. It was organized with a view of buying out and continuing the manufacturing business of Seymour, Sabin & Co. Upon its organization it purchased the manufacturing plant and the assets of that company, of the alleged value of \$2,617,000, including over \$1,250,000 of bills receivable, commonly known as "machine notes," and a large amount of "undivided profits" and "contracts," whatever that may mean. For these assets the car company issued and paid to Seymour, Sabin & Co. \$2,617,000 of its preferred stock, and \$1,500,000 of its common stock, the latter as "bonus." The car company thereupon engaged in the manufacturing business, while Seymour, Sabin & Co. continued the business of lumbering and merchandising. The latter proceeded to divide up among its own stockholders the stock of the car company, thus received, in exchange for its own stock, which was delivered up and cancelled, on the basis of two dollars of the former for one of the latter. The two companies continued in business about two years, during which they seem to have been in the habit of indorsing each other's paper for large amounts; at least, the car company indorsed that of Seymour, Sabin & Co. to the amount of \$500,000, which was outstanding when both companies failed. During these two years the car company paid \$360,000 in dividends to its preferred stockholders, no part of which, as respondent alleges, was ever earned.

In May, 1884, both companies being insolvent, their affairs were put into the hands of receivers,—the debts of Seymour, Sabin & Co. being over \$2,000,000, and its assets realizing at receiver's sale only \$45,000, or about two cents on the dollar of its indebtedness; and the debts of the car company being about \$3,400,000, and its assets, which were of a very miscellaneous character, estimated at \$4,372,000, but realizing at receiver's sale, two years afterwards, only \$1,150,000, which, after deducting expenses and several hundred thousand dollars liabilities contracted by the receiver, left only about \$225,000, or from 10 to 15 cents on the dollar for the creditors, and nothing, of course, for the stockholders. In November, 1884, some of the stockholders and creditors of the car company, with the view of saving something out of the wreck, organized the respondent, the Minnesota Thresher Manufacturing Company, with an authorized capital of \$7,000,000, viz., \$4,000,000 preferred stock, and \$3,000,000 common stock, on the following plan, to-wit: paid-up preferred stock to be issued in exchange for claims against the car company at par, and paid-up common stock, in exchange

for preferred stock of the car company, dollar for dollar. All of the stock of respondent has been issued on this plan; and included in the claims against the car company, for which respondent stock has been thus issued, are the indorsements of the car company upon the paper of Seymour, Sabin & Co., already referred to. The respondent has thus issued about \$1,700,000 of its preferred stock, and \$2,000,000 of its common stock, and thus become the owner of claims against the car company to the former amount, and of its stock to the latter amount. Down to April, 1887, the respondent alleges that it supposed that the assets of the car company would realize enough to pay its debts in full, and leave some surplus for its preferred stockholders; but since that date the respondent seems to have continued to issue its stock on the same basis or plan as before, except that those who exchange their preferred stock in the car company for the common stock of respondent are required to place the latter in the hands of certain trustees, to hold and vote for the term of five years. Common and preferred stock have the same voting power.

In 1887 the court ordered the receiver to sell *en masse* the entire assets of the car company, consisting of stock on hand, accounts, bills receivable to the amount of over \$1,500,000, claims against Seymour, Sabin & Co. to a large amount, and some stock in two other insolvent corporations. The respondent purchased the whole of these assets for \$1,150,000, and, in order to raise the amount of cash necessary to be paid on the purchase, (\$500,000,) devised a scheme by which it executed a mortgage or trust deed for \$1,600,000 on the entire property purchased, under which it issued and sold its bonds to the amount of \$1,173,000 to its preferred stockholders for 50 cents on the dollar, cash; they at the same time surrendering for cancellation and retirement one dollar of their stock for every two dollars of bonds purchased. After obtaining possession of the property thus purchased at the receiver's sale, which it alleges was worth more than double what it paid for it, the respondent engaged in the manufacturing of machinery at Stillwater, which it is still carrying on quite extensively, having, as it alleges, sold articles of its own manufacture since it commenced business of the value of \$1,100,000. As purchaser and owner of the large claims already referred to against Seymour, Sabin & Co. and the car company, the respondent has commenced, or is about to commence, the following suits: *First*, against the stockholders of Seymour, Sabin & Co. who exchanged their stock for that of the car company, it being claimed that such exchange was illegal, and in fraud of creditors; *second*, against the holders of the common stock of the car company, on the ground that they have never paid for the same; *third*, against the preferred stockholders

of the car company, to recover back the dividends received by them, on the ground that they were never earned.

The articles of association of respondent (Ex. F) state that the organization is formed "pursuant to, and in conformity with, an act of the legislature of the state of Minnesota entitled 'An act relating to manufacturing corporations,' approved March 7, 1873, and the several acts of the legislature amendatory thereof." Gen. St. 1878, c. 34, §§ 120-143. The articles state that "the objects for which the association is formed are the purchase of the capital stock, evidences of indebtedness issued by it, and the assets of the Northwestern Manufacturing & Car Company, a corporation existing under the laws of the state of Minnesota, or any portion of said capital stock, evidence of indebtedness or assets, and the manufacture and sale of steam engines of all kinds, farm implements and machinery of all kinds, and the manufacture and sale of all articles, implements, and machinery of which wood and iron, or either of them, form the principal component parts, and the manufacture of the materials therein used." These articles contain everything required by title 2, c. 34, except a statement of the highest amount of indebtedness to which the corporation should at any time be subject. The articles were also published and filed as required by that title. The directors also prepared a certificate in the form required by section 9 of the act of 1873, (Gen. St. 1878, c. 34, § 128,) in case of manufacturing corporations, but (as we construe the allegations of the answer) it was never filed.

Much of this history is perhaps irrelevant to any questions involved in these proceedings, but it will serve to convey a tolerably clear idea of the situation of things as presented by the record. The relator by his information stands admitting the corporate existence of the respondent, but claims upon the facts four grounds of forfeiture of its franchises for misuser, viz.: *First*, doing business without filing a certificate, as required by section 9 of the act of 1873; *second*, dealing in negotiable paper, and in the stock and indebtedness of other and insolvent corporations, and issuing its stock therefor; *third*, purchasing and retiring its own stock, to the prejudice of its creditors and stockholders; *fourth*, using its franchises and powers as an instrumentality of fraud and oppression, in bringing a large number of suits against the stockholders of Seymour, Sabin & Co., and the car company upon the claims referred to. This last is but a make-weight, and is not urged upon the argument. Taken by itself, there is nothing in it, for, if respondent had the power to purchase these claims, it has an undoubted right to bring suits on them to test the question of the personal liability of the stockholders of these defunct corporations.

The determination of the case will require the consideration of two leading questions: *First*, what kind of a corporation is the respondent? and, *second*, what is the office of an information in the nature of *quo warranto*, and what will constitute a misuser of corporate franchises such as to warrant a judgment of ouster in such proceedings?

The articles of association state that the corporation was formed under the act of 1873 relating to manufacturing corporations, but this does not make it so. To determine its actual character, we must look to the objects of its formation, and the nature of its business, as stated in the articles themselves. It cannot be made one kind of corporation merely by labeling it such, if its declared objects and purposes show it to be something else. No corporation can be organized under the act of 1873, except for an exclusively manufacturing or mechanical business. It does not authorize the organization of a corporation for the purpose of carrying on a manufacturing business, and also another and independent business not properly incident to or connected with manufacturing. This is clear from the very language of the act itself, as well as from the history of the causes leading to its enactment. It was passed immediately after the adoption of the constitutional amendment of 1872, excepting the stockholders of manufacturing and mechanical corporations from the personal liability imposed by article 10, § 3, of the constitution upon the stockholders of all corporations, and was doubtless passed to carry into effect the purpose of that amendment. That purpose was to encourage manufacturing enterprises by exempting those investing their capital in that business from personal liability. One other consideration that not improbably induced this exemption in favor of stockholders in purely manufacturing corporations was that ordinarily the added security to creditors of the personal liability of stockholders is less needed in the case of such corporations, inasmuch as manufacturing is the process of adding value to raw material by labor, and hence, if honestly conducted, is a safer business, and less liable to speculative risks than trade generally. But to extend the exemption to corporations combining manufacturing with some other distinct and independent business would at once defeat the object of the amendment of 1872, and also nullify the constitutional provision imposing a personal liability on the stockholders of all but manufacturing corporations; for this exemption could then be secured by attaching a very small manufacturing annex to a very large trading or speculating business, all the risks of the latter being immediately added to the whole business, and no inducement existing to invest any capital in the former, except the smallest possible amount necessary to bring the whole business within the constitutional

exemption. It is clear, therefore, to our minds that, under the act of 1873, a corporation can only be organized for carrying on an exclusively manufacturing or mechanical business, which, of course, includes anything that is properly incidental to or necessarily connected with such business. A corporation organized to carry on manufacturing and also some other lawful, but independent, business, belongs to the class authorized by title 2, c. 34, (sections 109-119.)

With this construction of the law in mind, it is not difficult, on examination of respondent's articles of association, to determine to what class it belongs. One of the declared objects of its formation is to purchase the capital stock and evidences of indebtedness of the car company, a business in no way incident to or properly connected with that of manufacturing. The contention of counsel to the contrary cannot be seriously entertained for a moment. If a manufacturing corporation desires to buy the plant of another corporation formerly engaged in the same business, that is legitimate, and if, in order to get it, it becomes necessary to buy with it some other property, not needed for nor connected with the manufacturing business, this also would be permissible, if done as incidental to the main purpose of securing the plant; but no such reason or excuse existed for buying the stock and indebtedness of the car company. Indeed, it would be difficult to imagine anything more foreign to or inconsistent with a legitimate manufacturing business than for a corporation to invest all its capital in the stock and indebtedness of another and insolvent corporation. Under title 2, a corporation can be organized to carry on any lawful business, and, if parties desire to deal in such speculative property, they can do so under that title, but not under the act of 1873, even by connecting it with manufacturing. Our conclusion, therefore, is that respondent is a corporation of the class authorized by title 2. That is what the incorporators themselves have characterized it by their statement of the objects of its formation. The articles of association were informal or defective in the one particular already mentioned, but we think this was cured by chapter 132, Gen. Laws 1887. But, in any event, respondent is a corporation either *de jure* or *de facto*, and it is immaterial here which; for, as already suggested, the relator is not in a position to question its corporate existence.

These views as to the corporate character of respondent dispose of relator's first ground for forfeiture, and in part, at least, of the second; for in the case of a corporation organized under title 2 no certificate, such as is described in Gen. St. 1878, c. 34, § 128, is required, and such a corporation may purchase the stock and indebtedness of another corporation if within the

objects expressed in its articles of association. Therefore there only remains to be considered the effect—*First*, of respondent's issuing its stock dollar for dollar for the stock and indebtedness of the car company, which was confessedly worth much less than par; and, *second*, of purchasing and retiring its own stock held by those who took its bonds.

While it is not necessary here to go at length into the subject, yet it is proper in this connection to consider briefly the second principal question referred to at the outset, viz., the office of an information in the nature of *quo warranto*, and what will amount to such a misuser of corporate franchises as to justify a judgment of forfeiture in such proceedings. And right here it is important to keep in mind certain distinctions which it seems to us counsel for relator have overlooked. And, first, these special proceedings upon information must not be confounded with a civil action, under Gen. St. 1878, chapter 79. Although, in a general sense, the two may be termed "concurrent remedies," yet it is undoubtedly true that the office or function of the latter has been enlarged somewhat beyond that of a common-law *quo warranto* information. In some jurisdictions, as formerly with us, the civil action is the only remedy. But while, *quo warranto* having been revived in this state, we have now the two remedies, yet the office of the writ of *quo warranto* ought not to be extended beyond what it was at common law. The remedy by civil action is more in accordance with the ordinary mode of judicial procedure in determining property rights, and ought to be pursued except in those special or exceptional cases where the public interests seem to demand a more speedy or summary mode of procedure than by action in the district court. The common law *quo warranto* information, as we have it to-day, is substantially as left by the changes and modifications made by the statute of 9 Anne, c. 20. The scope of the remedy furnished by it is to forfeit the franchises of a corporation for misuser or non-user. It is therefore necessary, in order to secure a judicial forfeiture of respondent's charter, to show a misuser of its franchises justifying such a forfeiture; and, as already remarked, the object being to protect the public, and not to redress private grievances, the misuser must be such as to work or threaten a substantial injury to the public, or such as to amount to a violation of the fundamental condition of the contract by which the franchise was granted, and thus defeat the purpose of the grant; and ordinarily the wrong or evil must be one remediable in no other form of judicial proceeding.

Courts always proceed with great caution in declaring a forfeiture of franchises, and require the prosecutor seeking the forfeiture to bring the case clearly within the rules of law entitling

him to exact so severe a penalty. It is also necessary to notice the distinction, frequently overlooked, between franchises and powers. The definition of a "franchise" given by Finch, adopted by Blackstone, and accepted by every authority since, is "a royal privilege or branch of the king's prerogative, subsisting in the hands of a subject." To be a franchise, the right possessed must be such as cannot be exercised without the express permission of the sovereign power,—a privilege or immunity of a public nature which cannot be legally exercised without legislative grant. It follows that the right, whether existing in a natural or artificial person, to carry on any particular business, is not necessarily or usually a franchise. The kinds of business which corporations organized either under title 2, c. 34, or under the act of 1873, are authorized to carry on, are powers, but not franchises, because it is a right possessed by all citizens who choose to engage in it without any legislative grant. The only franchise which such corporations possess is the general franchise to be or exist as a corporate entity. Hence, if they engage in any business not authorized by the statute, it is *ultra vires*, or in excess of their powers, but not a usurpation of franchises not granted, nor necessarily a misuser of those granted. Acts in excess of power may undoubtedly be carried so far as to amount to a misuser of the franchise to be a corporation and a ground for its forfeiture. How far it must go to amount to this the courts have wisely never attempted to define, except in very general terms, preferring the safer course of adopting a gradual process of judicial inclusion and exclusion as the cases arise. But we think it may be safely stated as the general *consensus* of the authorities that, to constitute a misuser of the corporate franchise, such as to warrant its forfeiture, the *ultra vires* acts must be so substantial and continued as to amount to a clear violation of the condition upon which the franchise was granted, and so derange or destroy the business of the corporation that it no longer fulfills the end for which it was created. But, in case of excess of powers, it is only where some public mischief is done or threatened that the state, by the attorney general, should interfere. If, as between the company and its stockholders, there is a wrongful application of the capital, or an illegal incurring of liabilities, it is for the stockholders to complain. If the company is entering into contracts *ultra vires*, to the prejudice of persons outside the corporation, such as creditors, it is for such persons to take steps to protect their interests. The mere fact that acts are *ultra vires* is not necessarily a ground for interference by the state, especially by *quo warranto*, to forfeit the corporate franchises. It should also be borne in mind that acts *ultra vires* may justify interference on part of the state by injunction to prohibit



a continuance of the excess of powers which would not be sufficient ground for a forfeiture in proceedings in *quo warranto*, and hence many of the numerous authorities cited by relator, being of that class, are not entirely in point here.

Applying these principles to the facts of this case, we think the state has failed to make out a case entitling it to judgment against respondent. Taking up, first, the issuing of its stock for the stock and indebtedness of the car company. None of the stockholders have any right to complain of this. They are all in the same boat. They got up the company for that express purpose and on that exact plan. A corporation may take property in payment of its stock, if it be done *bona fide*, and with no sinister or fraudulent purpose, and there be nothing in its charter or the nature of its business that forbids it. If this stock and indebtedness of the car company was taken in payment of respondent's stock with a fraudulent purpose, at fictitious values, in case the corporation becomes insolvent, creditors have their remedy against the stockholders as personally liable for stock not paid for. The alleged unlawful purchase and retirement of part of its own stock by the respondent stands on the same footing. If it is a wrong to other stockholders, they have a perfect remedy; and, so far as creditors are concerned, if the act is illegal, the parties who surrendered the stock would still be personally responsible as stockholders in case of the insolvency of the corporation. It may be that the plan on which this corporation is organized is not in accordance with the most approved financial principles, but with these financial matters we have nothing to do, except so far as they may affect the legal questions involved; and, upon the whole facts of the case, we do not think that, under the rules of law applicable, the state has made out a case entitling it to a judgment of forfeiture in these proceedings. It is also a consideration not without weight (although we do not place our decision upon it) that the consequences of whatever mistakes or unauthorized acts may have been made or done by respondent could not now be remedied by any such judgment. In view of the present condition of respondent's business, a dissolution of the corporation, and a forced winding up of its affairs, would involve new and additional loss to all parties concerned, both stockholders and creditors. The demurrer to the answer is therefore overruled, and the information dismissed.





